

EXHIBIT 1

(O-97-86)

ORDINANCE NUMBER O- 18385 (NEW SERIES)

ADOPTED ON MAR 04 1997

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AN ORDINANCE AMENDING CHAPTER II, ARTICLE 4, OF THE SAN DIEGO MUNICIPAL CODE BY ADDING DIVISION 14, ENTITLED "DEFERRED RETIREMENT OPTION PLAN," AND BY ADDING SECTIONS 24.1401, 24.1402, 24.1403, 24.1404, 24.1405, 24.1406, 24.1407, 24.1408, AND 24.1409, ALL RELATING TO THE RETIREMENT SYSTEM.

BE IT ORDAINED, by the Council of The City of San Diego, as follows:

Section 1. That Chapter II, Article 4, of the San Diego Municipal Code be and the same is hereby amended by adding a new division, Division 14, entitled "Deferred Retirement Option Plan," and by adding Sections 24.1401, 24.1402, 24.1403, 24.1404, 24.1405, 24.1406, 24.1407, 24.1408, and 24.1409, retroactively applicable to April 1, 1997, to read as follows:

DIVISION 14

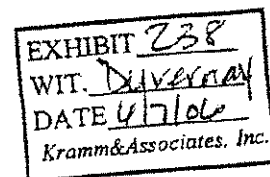
DEFERRED RETIREMENT OPTION PLAN

SEC. 24.1401 Purpose and Intent

a. A deferred retirement option plan (DROP) is hereby established effective April 1, 1997. The DROP plan is intended to allow Members who are eligible for service retirement to voluntarily elect an option to: (1) irrevocably waive their right to continue as a Member, (2) defer termination of City service for the duration of participation in DROP, and (3) defer receipt of their retirement

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allowance (calculated as of the date Membership status is waived) for the duration of participation in DROP.

b. It is also intended that the provision of this Division shall not in any way jeopardize the qualified status of the Retirement System under the rules and regulations of the Internal Revenue Service.

c. It is further intended that the Members of the Retirement System shall vote upon the establishment and implementation of this DROP benefit as a conditional benefit for a three (3) year trial basis. Election materials to the Members shall reflect the conditional nature of this benefit by clearly explaining that after three (3) years of implementation the cost of implementing this benefit shall be evaluated by the actuary for the Retirement System. If it is determined that implementation of DROP has the net effect of increasing the City's contributions to the Retirement System to a level greater than the savings realized by the elimination of employer contributions and the City's offset of employee contributions, then the City Council shall consider amendments to this Division to eliminate the availability of DROP for new participants. Council's action to prospectively eliminate the benefit, should that occur, shall not be subject to a vote of the Membership. If the determination of the Actuary is that DROP does not have the net effect of increasing the City's contributions to the Retirement System to a level greater than the savings realized by the elimination of employer contributions and the City's offset of employee contributions, the DROP benefit shall no longer be considered conditional and shall be treated the same as any other defined benefit of the Retirement System.



SEC. 24.1402 Eligibility

a. A Member shall not be eligible to elect participation in DROP until that Member attains eligibility for a service retirement under this Article.

b. Once a Member elects to participate in DROP, that DROP participant is no longer eligible for any rights, privileges, or benefits which require Membership in the System as a prerequisite to eligibility, except as specifically provided for in Sections 24.1402(c) and 24.1402(d).

c. DROP participants shall be eligible for the Special Death Benefit pursuant to Sections 24.0706, 24.0709, and 24.0710.2.

d. DROP participants shall be eligible to apply for conversion of their deferred service retirement allowance to a disability allowance in accordance with this Article calculated at the date of entry into the DROP.

SEC. 24.1403 Designation of the DROP Period

A Member who elects to participate in DROP shall irrevocably designate a specific consecutive period of months for participation in DROP not to exceed sixty (60) months. Any member who elects to participate in DROP shall be required to execute a legally binding waiver of Membership status, and further agree to terminate City service upon completion of the DROP period.

SEC. 24.1404 Duration of DROP Participation

Duration of the DROP period shall be determined by the first occurrence of any one of the following events.



- a. Completion of the period irrevocably designated by the participant at entry into the DROP, not to exceed sixty (60) months; or
- b. Termination of employment, either voluntarily or for cause. In the event that a DROP participant shall be terminated for cause and that termination is reversed, the DROP participant shall be reinstated in the DROP for the remaining unexpired period of participation; provided, however, that the DROP participant has not received a distribution from the DROP account; or
- c. Death of the DROP participant; or
- d. Granting of a disability retirement under the terms of this Article.

SEC. 24.1405 DROP Benefits

a. For Members who elect to participate in DROP, Membership status in the Retirement System shall cease; and a service retirement allowance will be calculated as if the Member were retiring from City service on the date the Member enters the DROP.

b. Upon commencement of DROP, certain funds shall be deposited into a trust account established for the benefit of the DROP participant. Upon deposit, all funds contributed into a DROP participants trust account shall be 100 percent vested. Contributions into a DROP participant's account shall include:

- (i) an amount contributed monthly from the City Employees' Retirement Fund which is equal to the monthly service retirement allowance calculated in accordance with Section 24.1405(a), and adjusted by any applicable COLA increases, and



(ii) periodic contributions of any Annual Supplemental Benefit payments, or any other adjustments applicable to retirement allowances being distributed on the date the Member entered the DROP, and

(iii) an amount contributed each pay period from The City of San Diego equal to 3.05% of the DROP participants salary, and

(iv) an amount contributed each pay period deducted pre-tax from the DROP participant's salary pursuant to Internal Revenue Code section 414(h)(2) which is equal to 3.05% of the DROP participant's salary, and

(v) interest credited to all sums paid into the DROP account in the same manner and at the same rate of interest as prescribed by the Board of Trustees for Member contribution accounts based on advice of the Retirement System actuary.

SEC. 24.1406 Designation of Beneficiary

a. DROP participants shall designate a beneficiary. If the DROP participant is married and the DROP participant desires to designate someone other than his or her spouse as the beneficiary, spousal consent and waiver of community property interest shall be required.

b. In the event of the death of a DROP participant during the DROP period, the total amount in the DROP participant's account shall be paid to the DROP participant's designated beneficiary, subject to any applicable community property laws.



SEC.24.1407 Distribution of Funds in DROP Account

The full amount accumulated in a DROP participant's account shall be distributed in a lump sum, or in any other form established by the Board of Administration, subject to applicable rules of the Internal Revenue Service. However, no funds shall be distributed from a DROP participant's account until the duration of the DROP period is completed pursuant to Section 24.1404 and the DROP participant has terminated City service.

SEC.24.1408 Employment Status during DROP Participation

Except for Membership status in the Retirement System, DROP participants shall retain all other rights, privileges, and benefits of active duty employment, and DROP participants shall be subject to the same terms and conditions of employment applicable to the DROP participant prior to entry into the DROP.

SEC. 24.1409 Health Benefits during DROP Participation

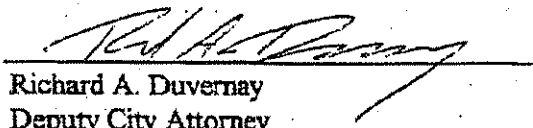
During participation in DROP, the DROP participant shall continue to be eligible for the City's Flexible Benefits Plan, including health benefits offered through that Plan. Upon completion of the duration of the DROP period as set forth in Section 24.1404 and distribution of DROP funds as set forth in Section 24.1407, the DROP participant shall qualify as a Health Eligible Retiree and be entitled to receive Retiree Health Benefits as provided for in Chapter II, Article 4, Division 12.



Section 2. This ordinance shall take effect and be in force upon approval by the respective classes of Membership of the Retirement System as required pursuant to Charter section 143.1 and no earlier than the thirtieth day from and after its passage by the City Council.

APPROVED: CASEY GWINN, City Attorney

By


Richard A. Duvernay
Deputy City Attorney

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EXHIBIT 2

CORRECTED COPY

(O-97-88 REV. 1)

ORDINANCE NUMBER O- 18392

(NEW SERIES)

ADOPTED ON MAR 31 1997

AN ORDINANCE AMENDING CHAPTER II, ARTICLE 4, OF THE SAN DIEGO MUNICIPAL CODE BY AMENDING DIVISION 1 BY AMENDING SECTION 24.0103, AMENDING AND RENUMBERING SECTION 24.0105 TO SECTION 24.0104; BY AMENDING DIVISION 2 BY AMENDING SECTIONS 24.0201, 24.0202 AND 24.0203; BY RENUMBERING SECTION 24.0206.5 TO SECTION 24.0207; BY RENUMBERING 24.0207 TO SECTION 24.0208; BY ADDING SECTION 24.0209, AND BY AMENDING SECTIONS 24.0210 AND 24.0211; BY AMENDING DIVISION 3 BY AMENDING SECTIONS 24.0301 AND 24.0302, AND BY ADDING SECTION 24.0309; BY AMENDING DIVISION 4 BY AMENDING SECTIONS 24.0402, 24.0403 AND 24.0404; BY AMENDING DIVISION 5 BY AMENDING SECTIONS 24.0521 AND 24.0532; BY AMENDING DIVISION 6 BY AMENDING SECTION 24.0608; BY AMENDING DIVISION 7 BY ADDING SECTION 24.0715; BY AMENDING DIVISION 8 BY AMENDING SECTION 24.0801; BY AMENDING DIVISION 9 BY AMENDING SECTION 24.0907; BY REPEALING DIVISION 12 AND BY REENACTING DIVISION 12 BY ADDING SECTIONS 24.1201, 24.1202, 24.1203, AND 24.1204; BY AMENDING DIVISION 13 BY AMENDING SECTIONS 24.1304, AND 24.1307, AND BY REPEALING SECTION 24.1311; BY REPEALING DIVISION 14 AND BY REENACTING DIVISION 14 BY ADDING SECTIONS 24.1401, 24.1402, 24.1403, 24.1404, 24.1405, 24.1406, 24.1407, 24.1408, AND 24.1409, ALL RELATING TO THE CITY EMPLOYEES' RETIREMENT SYSTEM.

WHEREAS, on July 2, 1996, after meeting and conferring with the Police Officers Association, Fire Fighters Local 145, Municipal Employees Association, and AFSCME, Local 127, the City Council approved a proposal to implement a number of revisions to the Retirement System; and

WHEREAS, on November 5, 1996, the passage of Proposition D amended City Charter Section 141 to permit the Retirement System to provide for health insurance to eligible retirees; and

WHEREAS, on February 6, 1997, a task force of the four labor organizations reached agreement with the City Management Team on the level of health benefits to be provided by the Retirement System; and

WHEREAS, it is the intent of the agreement reached between the four labor organizations and the City Management Team that the level of health benefits to be provided by the Retirement System not be diminished by any change in HMO health care providers by the City, or any new or amended contract with an HMO health care provider or by conversion to a blended premium for active employees and retirees without mutual agreement with the exclusive bargaining representatives; and

WHEREAS, the four labor organizations and the City Management Team have agreed that any change will not be approved by the City Council until after the proposed change has been reviewed by a qualified independent consultant, who is mutually selected and jointly compensated by the City and the recognized labor organizations, who concludes that the proposed changes will not affect the benefit in any manner which triggers the voting rights of active employees, unless this process is waived by mutual consent; and

WHEREAS, the four labor organizations and the City Management Team have reached agreement on the specific provisions to be included in the Deferred Retirement Option Plan; and

WHEREAS, the City wishes to ensure that retirees are provided with appropriate health benefits; and

WHEREAS, the best way to provide these benefits is through the Retirement System using the undistributed earnings of the System; and

WHEREAS, the tax laws put limits on the method the Retirement System can use to provide health benefits, and these limits are contained in Section 401(h) of the Internal Revenue Code; and

WHEREAS, Section 401(h) prevents a transfer of undistributed earnings of the Retirement System for paying health benefits; and

WHEREAS, Section 401(h) does not prevent undistributed earnings from being used in the place of City contributions if an equal amount of City contributions are designated for health benefits (known as the "bifurcated rate"); and

WHEREAS, if a bifurcated rate program is used, then the City and the Board agree the net economic consequences to the Retirement System and the City is the same as if undistributed earnings were used to directly provide health benefits, and agree the requirements of the tax law will be met; and

WHEREAS, the Board has obtained full and complete legal advice indicating it can enter into a bifurcated arrangement under the current ordinance and charter and has endorsed this arrangement; and

WHEREAS, the City and the Board have agreed the bifurcated rate arrangement is to be used for a "pay as you go" health program and this program will not be fully actuarially funded; and

WHEREAS, on February 10, Ordinance No. 0-97-75 was introduced amending numerous provisions of Chapter II, Article 4 of the San Diego Municipal Code related to the following:

service retirement and disability retirement formulae, elimination of the disability income offset, the establishment of a post retirement health benefit to be administered by the City Employees' Retirement System and establishment of a \$600 annual benefit for pre-1980 retirees who are not eligible for retiree health insurance, elimination of the remarriage penalty, modification of the one-year marriage requirement to establish eligibility as a surviving spouse, and purchase of service credit; and

WHEREAS, on February 18, 1997, Ordinance No. 0-97-86 was introduced by adding Division 14 to Chapter II, Article 4 of the San Diego Municipal Code establishing a Deferred Retirement Option Plan; and

WHEREAS, the City Council ordered all interested parties to move expeditiously toward completing the outstanding contingencies involved in Ordinances 97-75 and 97-86; and

WHEREAS, it is recommended a third ordinance be introduced (0-97-88) to "clean up" and technically amend language to assure that the provisions meet with and satisfy all applicable state and federal requirements; and

WHEREAS, all employees of the Unified Port District (the "District"), except for Harbor Police Officers, participate in the Retirement System as General Members, under a Retirement Agreement dated February 11, 1964 (the "Agreement"), on file with the City Clerk as Document No. 667149, as amended by a First Amendment to the Agreement, on file in the office of the San Diego City Clerk as Document No. 279991; and

WHEREAS, the changes to the Retirement System described in O-97-75 and 97-86 (collectively, the "Manager's Proposal") would automatically affect the District's Members unless otherwise provided by the Municipal Code or Agreement; and

WHEREAS, the Agreement needs to be amended because the District will not be participating in all of the benefits recommended in the Manager's Proposal; and

WHEREAS, the District and City intended to enter into a new agreement where the Board would administer District benefits as set forth in a separate plan document rather than the Municipal Code but there was not enough time to do the work necessary within the time line for the Manager's Proposal; and

WHEREAS, in the interim, the District proposed a Second Amendment to the Agreement ("Second Amendment to Agreement") which sets forth those benefits to be offered District employees as a result of the Manager's Proposal; and

WHEREAS, the Second Amendment to Agreement, attached to Resolution No. R-288414, is incorporated by reference herein; and

WHEREAS, Ordinances 97-75 and 97-86 were introduced prior to outside fiduciary counsel, tax counsel and plan consultant to the Retirement System completing reviews of the ordinance language implementing these benefit changes; and

WHEREAS, outside fiduciary counsel, tax counsel and plan consultant to the Retirement System have reviewed and approved the previous ordinances (0-97-75 and 0-97-86) as well as the Cleanup ordinance (0-97-88); and

WHEREAS, the Ordinance 97-88 does not introduce any changes to the agreements reached with the labor organizations; and

WHEREAS, it is now necessary and proper to amend the San Diego Municipal Code to reflect the changes to the benefits under the Retirement System set forth in 0-18383, 0-97-86 and this Cleanup ordinance (0-97-88); and

WHEREAS, in accordance with Section 143.1 of the Charter for The City of San Diego, the active membership will vote on April 4, 1997, through April 13, 1997, on the changes to the Retirement System set forth in 0-18383, 0-97-86 and this Cleanup ordinance; and

WHEREAS, the benefit improvements set forth in 0-18383, 0-97-86 and this Cleanup ordinance shall not become effective unless approved by the active members of the City Employees' Retirement System, NOW, THEREFORE,

BE IT ORDAINED, by the Council of The City of San Diego, as follows:

Section 1. That Chapter II, Article 4, Division 1, of the San Diego Municipal Code be and the same is hereby amended by amending Section 24.0103, to read as follows:

SEC. 24.0103 Definitions

Unless otherwise stated, for purposes of this Article:

"Accumulated Additional Contributions" means the sum of additional contributions standing to the credit of a Member's individual account and interest thereon.

"Accumulated Contributions" means Accumulated Normal Contributions plus any Accumulated Additional Contributions standing to the credit of a Member's account.

"Accumulated Normal Contributions" means the sum of all normal contributions standing to the credit of a Member's individual account and interest thereon.

"Actuarial Equivalent" means a benefit of equal value when computed upon the basis of the mortality, interest and other tables adopted by the Board for this purpose.

"Actuary" means the actuary regularly employed on a full or part-time basis by the Board.

"Annuity" means payment for life derived from contributions made by a Member.

"Beneficiary" means any person in receipt of a pension, annuity, retirement allowance, death benefit, or any other benefit authorized by this Article.

"Board" means the Board of Administration for the City Employees' Retirement System.

"City sponsored health insurance plan" means a group health insurance plan, selected by and in contractual privity with The City of San Diego, made available to Health Eligible Retirees.

"Compensation" means the remuneration paid in cash out of city funds controlled by the Council of The City of San Diego, plus the monetary value as determined by the Board of board, lodging, fuel, laundry and other advantages furnished to an employee in payment for the employee's services.

"Compensation Earnable" by a Member means the base compensation as determined by the Board for the period under consideration upon the basis of the normal number of days ordinarily worked by persons in the same grade or class of

positions during the period and at the same rate of pay. The computation for any absence shall be based on the compensation of the position held by such employee at the beginning of the absence.

"Continuous Service" means service of an eligible Member deemed to be of a continuous nature pursuant to Section 24.1005 of this Code. "Continuous Service" shall not be construed as synonymous with "Creditable Service."

"Cost of Living Annuity" means an amount to be added to the retirement allowance of a Member or Officer, calculated by computing the actuarial equivalent of the accumulated contributions in the cost of living annuity account of the Member or Officer at the time of the retirement of the Member or Officer.

"Creditable Service" for purposes of qualification for benefits and retirement allowances under this System means service rendered for compensation as an employee or officer (employed, appointed or elected) of the City or a contracting agency, and only while he or she is receiving compensation from the City or contracting agency, and is a Member of and contributing to this System pursuant to appropriate provisions of this Article. Except as provided in Chapter II, Article 4, Division 13, for which repurchase of credits may be permissible, time during which a Member is absent from City service without compensation shall not be allowed in computing Creditable Service. The term "Current Service" shall mean the same as Creditable Service.

"DROP" means Deferred Retirement Option Plan, an alternative method of benefit accrual described in Division 14.

"Final Compensation" for General Members and Legislative Officers means the Compensation Earnable based on the highest one-year period for those Members and Officers who are on the active payroll of The City of San Diego on or after June 30, 1989, and who retire on or after July 1, 1989. The Board shall adjust contribution rates for high one-year General Member and Legislative Officer eligibles as may be necessary and required upon advice of the Actuary, from and after December 30, 1988.

"Final Compensation" for Safety Members means the Compensation Earnable based on the highest one-year period, for those Safety Members who are on the active payroll of The City of San Diego on or after January 1, 1988, and who retire on or after July 1, 1988. The Board shall adjust contribution rates for high one-year Safety Member eligibles as may be necessary and required upon advice of the Actuary, from and after January 1, 1988.

"General Member" is any Member not otherwise classified as a Safety Member or Legislative Officer.

"Health Eligible Retiree" means any retired General Member, Safety Member, or Legislative Officer who (1) was on the active payroll of The City of San Diego on or after October 5, 1980, and (2) retires on or after October 6, 1980, and (3) is eligible for and is receiving a retirement allowance from the Retirement System.

"Investment Earnings Received" means all interest received (net of interest purchased) on notes, bonds, mortgages, short-term money market

instruments, and savings accounts; cash dividends received on stock investments; and all realized gains and losses from the sale, trade, or conversion of any investments of the Retirement System.

"Legislative Officers" means the Mayor and/or members of the City Council.

"Member" means any person who actively participates in and contributes to the Retirement System, and who is thereafter entitled, when eligible, to receive benefits therefrom. There are two classes of Members: General and Safety.

"Normal Contributions" means contributions by a Member at the normal rates of contribution, but does not include additional contributions by a Member.

"Prior Service" means service prior to January 1, 1927.

"Qualified Retiree" means those retirees eligible to receive the annual supplemental benefit set forth in Division 4.

"Retirement Fund" means the trust fund created by the City Charter in Article IX.

"Retirement System" or "this System" means the City Employees Retirement System as created by this Article, and the "1981 Pension System" means the Employees Retirement System as created by Chapter II, Article 4, Division 11.

"Safety Member" means any person who is either a sworn officer of the Police Department of The City of San Diego employed since July 1, 1946, a uniformed member of the Fire Department of The City of San Diego employed

since July 1, 1946, or a full-time employed lifeguard of The City of San Diego, or a full-time police officer of the Unified Port District who is a peace officer under Penal Code section 830.1(a); provided, however, that police cadets, persons sworn for limited purposes only, and all other members of the Police and Fire Departments and lifeguard service shall not be considered Safety Members for the purpose of this Article.

"Undistributed Earnings Reserve" shall mean the balance remaining in the account to which the earnings to the fund are credited, after the annual distribution to the employee and employer reserve accounts in accordance with interest assumption rates established by the Board, plus accumulated earnings which have not been so distributed.

Section 2. That Chapter II, Article 4, Division 1, of the San Diego Municipal Code be and the same is hereby amended by amending and renumbering Section 24.0105 to Section 24.0104, to read as follows:

SEC. 24.0104 Membership

a. and b. [No change in text.]

c. Employees in the classified service paid on an hourly basis are not eligible for membership in the Retirement System nor shall they accrue any benefits in this system except as provided in Section 24.1304. Salaried employees in the classified service including those working one-half ($\frac{1}{2}$) or three-quarter ($\frac{3}{4}$) time are eligible for and shall become members of the Retirement System. Retirement benefits shall accrue to the above eligible members in the same

proportion to full benefits as their service relates to the service of a full-time member.

d. and e. [No change in text.]

Section 3. That Chapter II, Article 4, Division 2, of the San Diego Municipal Code be and the same is hereby amended by amending Section 24.0201, to read as follows:

SEC. 24.0201 Contribution of General Members

For General Members, the Board shall provide:

1. [No change in text.]
2. The normal rates of contribution for each Member, except Safety Member shall be such as will provide an average Annuity at age 57½ equal to 1/120th of the Member's Final Compensation, according to the tables adopted by the Board for each year of service rendered after entering the System.
3. An employee who is granted a special leave of absence without pay in order to serve as the duly elected president of a recognized employee labor organization, shall be permitted, if he or she so elects, to continue making contributions during the period of presidential leave in an amount prescribed in accordance with Section 24.1307.

Section 4. That Chapter II, Article 4, Division 2, of the San Diego Municipal Code be and the same is hereby amended by amending Section 24.0202, to read as follows:

SEC. 24.0202 Adoption of General Member Contribution Rates

The Board, based upon the advice of the Actuary, shall periodically adopt the rate of contribution of each General Member according to age at the time of entry into the Retirement System, said rates to be contained in the Operating Tables furnished to the Board by the System's Actuary.

Section 5. That Chapter II, Article 4, Division 2, of the San Diego Municipal Code be and the same is hereby amended by amending Section 24.0203, to read as follows:

SEC. 24.0203 Maximum and Minimum Rates for General Members

The normal rate of contribution established for age 57 is the rate for any member other than a safety member who has attained a greater age before entrance into the Retirement System, and that established for age 20 is the rate for any member who enters the Retirement System at a lesser age.

Section 6. That Chapter II, Article 4, Division 2, of the San Diego Municipal Code be and the same is hereby amended by renumbering Section 24.0206.5 to Section 24.0207, to read as follows:

SEC. 24.0207 Termination of Benefits - General Member

[No change in text.]

Section 7. That Chapter II, Article 4, Division 2, of the San Diego Municipal Code be and the same is hereby amended by renumbering Section 24.0207 to Section 24.0208, to read as follows:

SEC. 24.0208 Auditor and Comptroller to Withhold Monies Owing City-General Members

[No change in text.]

Section 8. That Chapter II, Article 4, Division 2, of the San Diego Municipal Code be and the same is hereby amended by adding Section 24.0209, to read as follows:

SEC. 24.0209 Annuity, Actuarial Equivalent of General members' Accumulated Contributions

The actual amount of annuity receivable by a General Member upon retirement shall be the actuarial equivalent of the General Member accumulated contributions.

Section 9. That Chapter II, Article 4, Division 2, of the San Diego Municipal Code be and the same is hereby amended by amending and renumbering Section 24.0211 to Section 24.0210, to read as follows:

SEC. 24.0210 Upgrade of Benefits - General Members

Effective July 1, 1991, any General Member who was enrolled and participating in the 1981 Pension Plan between September 3, 1982, and June 30, 1989, shall receive the same level of benefits provided to General Members in CERS, except as provided in Section 24.0501(b).

Section 10. That Chapter II, Article 4, Division 3, of the San Diego Municipal Code be and the same is hereby amended by amending Sections 24.0301 and 24.0302, to read as follows:

SEC. 24.0301 Contributions of Safety Members

For Safety Members, the Board shall provide:

1. [No change in text.]

2. The normal rates of contribution for each Safety Member shall be such as will provide an average Annuity at age 50 equal to 1/100th of his Final Compensation, according to the tables adopted by the Board for each year of service rendered after entering the System.

3. An employee who is granted a special leave of absence without pay in order to serve as the duly elected president of a recognized employee labor organization, shall be permitted, if he or she so elects, to continue making contributions during the period of presidential leave in an amount prescribed in accordance with Section 24.1307.

SEC. 24.0302 Adoption of Safety Member Contribution Rates

The Board, based upon the advice of the Actuary, shall periodically adopt the rate of contribution of each Safety Member according to age at the time of entry into the Retirement System, said rates to be contained in the Operating Tables furnished to the Board by the System's Actuary.

Section 11. That Chapter II, Article 4, Division 3, of the San Diego Municipal Code be and the same is hereby amended by adding Section 24.0309, to read as follows:

**SEC. 24.0309 Annuity, Actuarial Equivalent of Safety Members'
Accumulated Contributions**

The actual amount of annuity receivable by a Safety Member upon retirement shall be the actuarial equivalent of the Safety Member accumulated contributions.

Section 12. That Chapter II, Article 4, Division 4, of the San Diego Municipal Code be and the same is hereby amended by amending Sections 24.0402, 24.0403 and 24.0404, to read as follows:

SEC. 24.0402 Retirement Allowance -- General Member

a. The Board shall provide that upon retirement for service, a General Member, is entitled to receive a retirement allowance which shall consist of:

(1) A service retirement annuity.

(2) A current service pension.

b. and c. [No change in text.]

d. The unmodified service retirement allowance is calculated by multiplying a General Member's years of creditable service by the retirement percentage set forth in Table 1 of Section 24.0402, by the General Member's Final Compensation. The factors set forth in Table 1 of Section 24.0402 shall be pro-rated to reflect quarterly increments in the General Member's attained age.

Table 1 of Section 24.0402

RETIREMENT CALCULATION FACTOR

GENERAL MEMBER

Retirement Age	Unmodified Factor* Effective 1/1/97
55	2.00%
56	2.00%
57	2.00%
58	2.00%
59	2.08%
60	2.16%
61	2.24%
62	2.31%
63	2.39%
64	2.47%
65+	2.55%

* Unmodified Factor utilized to calculate the maximum service retirement allowance. Retirement allowances are actuarially reduced if Member elects any optional retirement settlements pursuant to Division 6 of this Chapter.

SEC. 24.0403 Retirement Allowances -- Safety Member

a. The Board shall provide that upon retirement from service a Safety

Member is entitled to receive a retirement allowance which shall consist of:

1. and 2. [No change in text.]

b. and c. [No change in text.]

d. Subject only to the retirement allowance cap described in Section 24.0403(e), the unmodified service retirement allowance is calculated by multiplying a Safety Member's years of creditable service by the retirement percentage set forth in Table 1 of Section 24.0403 by the Safety Member's Final Compensation. The factors set forth in Table 1 of Section 24.0403 shall be prorated to reflect quarterly increments in the Safety Member's attained age.

e. The unmodified service retirement allowance for a Safety Member shall not exceed 90% of Final Compensation except as provided in Sections 24.0403(f), 24.0403(g), and 24.0403(h).

f. If the unmodified service retirement allowance of a Safety Member would have exceeded 90% of Final Compensation using the Retirement Calculation Factors in effect on December 31, 1996, as shown in Table 1 of Section 24.0403, that Safety Member may elect to continue to accrue benefits under that Table and not be subject to the 90% retirement allowance cap set forth in Section 24.0403(e). A Safety Member making such election shall not be required to pay any additional contributions as recommended by the actuary related to the increase in benefits effective January 1, 1997.

g. If the unmodified service retirement allowance of a Safety Member would have exceeded 90% of Final Compensation using the Retirement Calculation Factors in effect on December 31, 1996, as shown in Table 1 of Section 24.0403, that Safety Member may elect to accrue benefits as shown in the

schedule effective January 1, 1997, on that Table. A Safety Member making such election shall:

- (1) Be eligible to accrue benefits in excess of the 90% limitation stated in Section 24.0403(e),
- (2) Not be eligible to participate in DROP pursuant to Division 14.
- (3) Retire no later than July 1, 1997.

h. If the unmodified service retirement allowance of a Safety Member exceeds 90% of Final Compensation using the Retirement Calculation Factors in effect on January 1, 1997, as shown on Table 1 of Section 24.0403 on a date after January 1, 1997, but before April 1, 1997, that Safety Member shall accrue benefits in excess of the 90% limitation stated in Section 24.0403(e), provided, however, that the accrual shall cease at the level attained on March 31, 1997.

Table 1 of Section 24.0403

RETIREMENT CALCULATION FACTOR

LIFEGUARDS

Retirement Age	Unmodified Factor* Effective 12/31/96	Unmodified Factor* Effective 1/1/97
50	2.00%	2.20%
51	2.10%	2.32%
52	2.22%	2.44%
53	2.34%	2.57%
54	2.47%	2.72%
55+	2.62%	2.77%

* Unmodified Factor utilized to calculate the maximum service retirement allowance. Retirement allowances are actuarially reduced if Member elects any optional retirement settlements pursuant to Division 6 of this Chapter.

RETIREMENT CALCULATION FACTOR

FIRE AND POLICE

Retirement Age	Unmodified Factor*		Unmodified Factor*
	Effective 12/31/96		Effective 1/1/97
	Police	Fire	
50	2.50%	2.20%	2.50%
51	2.54%	2.32%	2.60%
52	2.58%	2.44%	2.70%
53	2.62%	2.57%	2.80%
54	2.66%	2.72%	2.90%
55	2.70%	2.77%	2.9999%
56+	2.77%	2.77%	2.9999%

* Unmodified Factor utilized to calculate the maximum service retirement allowance. Retirement allowances are actuarially reduced if Member elects any optional retirement settlements pursuant to Division 6 of this Chapter.

SEC. 24.0404 Annual Supplemental Benefit -- Qualification and Determination

The purpose and intent of this section is to provide necessary guidelines for effectuating the payment of annual supplemental benefits set forth in Section 24.0907 of this Code by (a) identifying and defining those retirees qualified to receive such benefit and (b) establishing a method for determining the amount of the annual supplemental benefit.

A. [No change in text.]

B. For the purpose of determining the amount of the supplemental benefit payment to Qualified Retirees, the following process shall apply:

1. through 3. [No change in text.]

4. The total sum of qualified creditable years shall then be divided into the total of Surplus Undistributed Earnings designated for distribution by the Board pursuant to Section 24.0907 of this Code to arrive at a per annum dollar value for each creditable year; provided, however, that in no event shall the per annum dollar value exceed \$30 (thirty dollars) except for those General Members who retired between January 8, 1982 and June 30, 1985, who shall be entitled to a per annum value not to exceed \$45 (forty-five dollars).

Notwithstanding the preceding paragraph, and effective Fiscal Year 1997, qualified retirees who retired on or before October 6, 1980, but after December 31, 1971, will receive \$60 (sixty dollars) per year of service and qualified retirees who retired on or before December 31, 1971, will receive \$75 (seventy-five dollars) per year of service.

5. through 7. [No change in text.]

C. [No change in text.]

Section 13. That Chapter II, Article 4, Division 5, of the San Diego Municipal Code be and the same is hereby amended by amending Sections 24.0521, to read as follows:

SEC. 24.0521 Surviving Spouse--Contribution Rates and Benefits

From and after July 1, 1973, every Member, shall, in addition to Normal Contributions, make survivor contributions in an amount equal to a percentage of the Normal Contributions as set forth below:

Membership Classification	Survivor Contributions as Percentage of Normal Contributions
General Members	9.98%
Safety Members	11.76%

Such survivor contributions, together with interest thereon, shall be paid to the Member or his or her beneficiary in the event the Normal Contributions are so paid under Sections 24.0206, 24.0306, and 24.0703.

Upon the death of any Member who retires for service or disability after the effective date of this section, his or her surviving spouse shall receive, on July 1, 1973 and thereafter, a monthly allowance equal to 50% of the decedent's monthly retirement allowance if:

(1) and (2) [No change in text.]

(3) the monthly retirement allowance of the deceased Member was not modified in accordance with Optional Settlement 1, 2, 3, or 4 provided by this System.

No benefits will be paid under this section if there is a surviving spouse who qualifies for and receives the special death benefit or modified special death benefits provided by this System.

Upon the retirement of a Member for service or disability having no spouse at the time of retirement who is eligible for benefits under this section the Member shall have the option of having refunded to him or her in lump sum the Accumulated Contributions including interest made pursuant to this section, or of having these contributions treated as voluntary additional contributions made to provide a larger Annuity benefit.

Section 14. That Chapter II, Article 4, Division 5, of the San Diego Municipal Code be and the same is hereby amended by amending Section 24.0532, to read as follows:

SEC. 24.0532 Cost of Living Adjustment Program Shared Between Employer and Members

The cost of any anticipated cost of living increase in allowances which is based upon services rendered after July 1, 1971, shall be shared equally between the employer and the contributing Member, with the individual member's contributions based upon his or her age at his or her nearest birthday at time of entrance into the Retirement System.

Commencing July 1, 1971, and until adjusted by the Board upon the recommendation of the Actuary, the contribution requirements of Members as contained in Sections 24.0202 and 24.0302, respectively, plus surviving spouse contributions as contained in Section 24.0521, shall be increased by 15%. In addition, the contribution requirement for those Members specified therein who are active Members on or after June 30, 1985, shall be increased by 20%. These "cost of living contributions" will be separately totaled upon the retirement of Members after July 1, 1971.

Section 15. That Chapter II, Article 4, Division 6, of the San Diego Municipal Code be and the same is hereby amended by amending Section 24.0608, to read as follows:

SEC. 24.0608 Social Security Integrated Option

All members of the City Employees' Retirement System who, on and after the integration date are entitled to Social Security benefits, shall have an option as follows:

Upon receipt of evidence furnished by the eligible member that said member will be entitled to Social Security benefits at age 65, the said eligible member upon retirement may request and the Board shall grant a modified retirement allowance which will be the actuarial equivalent of the unmodified retirement allowance; such retirement allowance shall be so modified as to provide a greater monthly payment before the first of the month in which the member attains the age of 65 and a lesser monthly payment commencing on such date; such greater monthly payment shall equal the sum of the lesser monthly payment plus the estimated individual's Old Age Insurance Benefits which will be payable. This modified allowance may be further modified on an actuarial basis in accordance with the provisions of Sections 24.0603, 24.0604, 24.0605, 24.0606 or 24.0607.

For officers and employees of The City of San Diego hired prior to January 1, 1982, the above provisions shall apply for that period of Social Security coverage prior to January 1, 1982. Subsequent to the withdrawal date

(December 31, 1981), all provisions for social security integration shall be inapplicable to such employees except for the prior period of vesting.

Section 16. That Chapter II, Article 4, Division 7, of the San Diego Municipal Code be and the same is hereby amended by adding Section 24.0715, to read as follows:

SEC. 24.0715 Continued Health Coverage

Any surviving spouse eligible for death benefits pursuant to Sections 24.0705, 24.0706, 24.0709, 24.0710, 24.0710.1, 24.0710.2 and 24.0710.3 shall be entitled to continued health coverage as provided in California Labor Code Section 4856.

Section 17. That Chapter II, Article 4, Division 9, of the San Diego Municipal Code be and the same is hereby amended by amending Section 24.0907, to read as follows:

SEC. 24.0907 Surplus Undistributed Earnings

a. Surplus Undistributed Earnings shall be comprised of Investment Earnings Received for the previous fiscal year, less:

(1) An amount sufficient to credit interest to the contribution accounts of the Members, City and the Unified Port District at an interest rate determined by the Board and distributed in accordance with Section 24.0905 and related Board rules; and

(2) An amount sufficient to meet the budgeted expenses and costs of operating the System including all personnel and services for the fiscal year; and

Corrected copy

(3) An amount necessary to maintain such reserves as the Board deems appropriate on advice of its investment counselor and/or Actuary; and

(4) An amount sufficient to credit the Unified Port District ("UPD") with a proportional share of Surplus Undistributed Earnings as defined in this Section.

(5) An amount, (the Division 12 amount), appropriate to provide health benefits to Health Eligible and Non Health Eligible Retirees as provided in Division 12 for the next fiscal year provided:

(a) in the next fiscal year, the City contributes to the 401(h) Fund no less than an equal amount which is designated to be used for retiree health benefits to be paid or reimbursed in the next fiscal year; and,

(b) to the extent the City makes a contribution to the 401(h) Fund for the next fiscal year, the Division 12 amount shall be treated as a portion of normal employer contributions paid to the Retirement System when the City so designates in accordance with Section 24.1203(b)(5).

(6) An amount sufficient to provide necessary funds to pay an annual supplemental benefit to qualified retirees, pursuant to the provisions and conditions set forth in Section 24.0404. If, at the time of the annual determination, the amount provided for the supplemental benefits is less than

\$100,000, no supplemental benefits will be paid in that fiscal year and the monies will be placed in a special reserve and be carried forward to ensuing years until such time as the amount to be provided for this benefit from ensuing Surplus Undistributed Earnings and the special reserve is \$100,000 or more.

b. At the beginning of each fiscal year, the Board shall credit all Surplus Undistributed Earnings to the Reserve for Employer Contributions, for the sole and exclusive purpose of reducing Retirement System liability.

c. For the purpose of distributing annual supplemental benefits to qualified retirees, Investment Earnings Received shall be determined on a cash basis, except that Investment Earnings Received shall be increased or decreased by the amount of the annual amortization of purchase discounts or premiums on interest-bearing investments earned in accordance with generally accepted accounting principles for financial reporting purposes. No subsequent changes in the method of accounting for the Retirement System shall affect the determination of Investment Earnings Received. Surplus Undistributed Earnings shall be determined by the City Auditor and Comptroller in accordance with this section and shall be certified by the City's independent public accountant.

Section 18. That Chapter II, Article 4, Division 12, of the San Diego Municipal Code be and the same is hereby amended by repealing Division 12.

Section 19. That Chapter II, Article 4, Division 12, of the San Diego Municipal Code be and the same is hereby amended by reenacting and adding Sections 24.1201, 24.1202, 24.1203, and 24.1204, to read as follows:

DIVISION 12

Post Retirement Health Benefits

SEC. 24.1201 Eligible Retirees

(a) Effective August 1, 1997, two separate post retirement health benefits shall be offered, one to Health Eligible Retirees and the other to Non Health Eligible Retirees as set forth in this Division. A Health Eligible Retiree is any General Member, Safety Member or Legislative Officer who: (1) was on the active payroll of The City of San Diego on or after October 5, 1980, and (2) retires on or after October 6, 1980, and (3) is eligible for and is receiving a retirement allowance from the Retirement System. A Non Health Eligible Retiree is any retiree who: (1) retired or terminated employment as a vested member from The City of San Diego prior to October 6, 1980; and (2) is eligible for and is receiving a retirement allowance from the Retirement System.

(b) Health Eligible Retirees who retired on or after July 1, 1992 under the "sliding scale " benefit in existence at the time of their retirement shall have their Retiree Health Benefit prospectively adjusted on August 1, 1997, to be the same as that for Health Eligible Retirees who retire on or after August 1, 1997.

SEC. 24.1202 Post Retirement Health Benefits Defined

(a) Non Health Eligible Retirees shall be entitled to payment or reimbursement of an amount not to exceed \$600.00 per year for health insurance expenses.

(b) Health Eligible Retirees shall be entitled to participate in and obtain health coverage under any currently available City sponsored health insurance plan or any other health insurance plan of their choice and have their premiums paid or reimbursed in accordance with the limitations set forth in this Division.

(c) Regardless of the health insurance plan selected, payment or reimbursement to a Health Eligible Retiree shall not exceed the lower of (1) the cost of the Medicare eligible or Non-Medicare eligible retiree-only premium for the highest cost Health Maintenance Organization (HMO) plan which is a City sponsored health insurance plan, or (2) the actual premium cost incurred by or for the Health Eligible Retiree.

(d) A Health Eligible Retiree timely enrolled in Medicare shall also be entitled to reimbursement of the cost of the part B supplemental medical expense premium.

(e) A Health Eligible Retiree who, on January 1, 1997, was enrolled in and who remains continuously enrolled in any Preferred Provider Organization (PPO), shall not be subject to the limitation set forth in (c)(1) of this section. Instead, the limitation shall not exceed the cost of the Medicare eligible or Non-Medicare eligible retiree-only premium for the City sponsored PPO plan made available to Health Eligible Retirees.

SEC. 24.1203401(h) Fund Established

(a) All post retirement health benefit payments pursuant to this Division shall comply with all applicable Federal laws, including Section 401(h) of the Internal Revenue Code ("Code"). To the extent there may be a conflict between the rules of this Division and Section 401(h) of the Code or regulations issued thereunder, the Code and regulations shall govern.

(b) 401(h) Fund - Compliance with Applicable Provisions of the Code

(1) All health benefits pursuant to this Division shall be paid solely from the 401(h) Fund established pursuant to Code Section 401(h) and any regulations issued thereunder.

(2) No health benefits provided under the 401(h) Fund shall discriminate in favor of highly compensated employees.

(3) The 401(h) Fund shall be a separate account solely for providing health benefits and shall be established and maintained by the Board to reflect the amounts contributed for the payment of post retirement health benefits. This account shall be for record keeping purposes only. Amounts credited to the 401(h) Fund may be invested with other Retirement System funds set aside for retirement purposes, without identification of which investments are allocable to each account. However, earnings on each account shall be allocated to each in a reasonable manner.

(4) Contributions to the 401(h) Fund shall be made by the City solely to pay and make reimbursement for health benefits for retirees eligible for health benefits. Contributions shall be reasonable, ascertainable, necessary and appropriate. Contributions shall not exceed the amounts that, under the Code, would violate the rule that requires health benefits to be subordinate to the retirement benefits.

(5) The City must, at the time it makes a contribution to the 401(h) Fund, designate in writing to the Board that portion of the contribution allocable to the 401(h) Fund to be used solely for health benefits.

(6) Prior to the satisfaction of all liabilities under the Retirement System to provide for health benefits, no part of the 401(h) Fund shall be used for, or diverted to, any purpose other than providing health benefits, except that, amounts credited to the 401(h) Fund may be used to pay for necessary and appropriate administrative expenses related to post retirement health benefits.

(7) Any amounts contributed to the 401(h) Fund and which remain in the 401(h) Fund after the satisfaction of all liabilities for health benefits (including but not limited to benefits payable in the future for existing members) shall be returned to the City. The City shall provide benefits to affected members and retirees of the Retirement System equivalent to any amount so returned.

(8) This section does not require separate accounts for key employees because no member of the Retirement System is a key employee under the definitions of the Code.

(9) Assets attributable to any forfeitures of benefits payable under the 401(h) Fund shall be used to reduce the City's contributions to pay for health benefits provided under the 401(h) Fund.

(c) The Board may adopt such rules and regulations pursuant to Section 24.0901 as necessary or appropriate to carry out the requirements of this Division.

SEC. 24.1204 Funding

Post retirement health benefits described in this Division shall be paid from the following sources of funds in descending order of availability, as may be appropriate to provide the benefits set forth in this Division:

(a) from the 401(h) Fund, to the extent of monies therein; and, if necessary,

(b) by the City, directly, from any source of funds available to The City of San Diego.

Section 20. That Chapter II, Article 4, Division 13, of the San Diego Municipal Code be and the same is hereby amended by amending Sections 24.1304, and 24.1307, to read as follows:

SEC. 24.1304 Purchase of Service Credit for Part-Time or Hourly Service in Positions not Eligible for Membership

Upon vesting, any Member who was employed by the City in a position that was less than full-time or was otherwise not eligible for membership, may purchase full-time service credit for the period of time he or she rendered part-time or hourly service prior to membership.

No employee shall be eligible to purchase service credit under this Section for periods of employment after January 1, 1997.

SEC. 24.1307 Purchase of Approved Leaves of Absence

(a) Notwithstanding the definition of Creditable Service in Section 24.0103, any Member granted an approved leave of absence shall have the right, upon his or her return to City service, and upon request by the Member, to obtain service credit for a period of up to one year of such absence by paying into the Retirement System an amount determined by the Board to be the equivalent of the employee cost of that service.

(b) Notwithstanding the definition of Creditable Service in Section 24.0103, any Member granted an approved leave of absence for periods of time in excess of one year shall have the right, upon return to City service, and upon request by the Member, to obtain service credit for such excess leave of absence by paying into the Retirement System an amount determined by the Board to be the equivalent of the employee and employer cost of that service.

(c) A member is not eligible to purchase service credit under Section 24.1307(a) or (b) for periods of leave of absence that begin after January 1, 1997,

except for leaves of absence granted by the City for long term disability benefits, Family Medical Leave Act periods approved by the City, leaves of absence without pay approved by the Civil Service Commission with job to be saved, including any period preceding reinstatement by the Civil Service Commission following a termination appeal.

Section 21. That Chapter II, Article 4, Division 13, of the San Diego Municipal Code be and the same is hereby amended by repealing Section 24.1311.

Section 22. That Chapter II, Article 4, Division 14, of the San Diego Municipal Code be and the same is hereby amended by repealing Division 14.

Section 23. That Chapter II, Article 4, Division 14, of the San Diego Municipal Code be and the same is hereby amended by reenacting Division 14, by adding Sections 24.1401, 24.1402, 24.1403, 24.1404, 24.1405, 24.1406, 24.1407, 24.1408 and 24.1409, to read as follows:

DIVISION 14

DEFERRED RETIREMENT OPTION PLAN

SEC. 24.1401 Purpose and Duration

a. Effective April 1, 1997, a deferred retirement option plan (DROP) is created and offered to Members on a voluntary basis as an alternative method of benefit accrual in the Retirement System as set forth in this Division.

b. DROP is created to add flexibility to the Retirement System. It provides Members who elect to participate in the program access to a lump sum

benefit in addition to their normal monthly retirement allowance at their actual retirement. DROP is intended to be cost neutral regarding plan funding.

c. The DROP plan shall be offered on a trial basis for a period of three years commencing April 1, 1997 and ending March 31, 2000. During this three year trial period, DROP shall be evaluated by the City on a cost basis. During and by the end of this three year period, the city will determine whether the costs of DROP, including but not limited to any increase to the employer contribution rate recommended by the System's actuary specifically related to DROP, are greater than any savings realized as a result of the implementation of DROP. If the City determines DROP to not be cost effective, the City may determine not to extend DROP for elections that would otherwise have been made by Members after April 1, 2000. If the City determines DROP to be cost effective, or takes no action to eliminate further DROP participation, DROP shall become a permanent benefit effective April 1, 2000.

SEC. 24.1402 Eligibility, Duration of DROP Participation, and Waiver

a. Any Member, except a Safety Member who elects to accrue benefits pursuant to Section 24.0403 (g), who has attained the age and service necessary to be eligible for service retirement shall be eligible to participate in DROP.

b. Any member who elects to participate in DROP shall voluntarily and irrevocably:

(1) Designate a period of participation not to exceed sixty (60) consecutive months.

(2) Cease, from and after the date the Member begins participating in DROP, to accrue benefits under any other Division of this Article.

(3) Have DROP benefits credited to a DROP Participation Account pursuant to Section 24.1404.

(4) Accrue benefits from and after the date the Member begins participating in DROP pursuant to the terms of this Division.

(5) Receive benefits from the Retirement System upon termination of City employment at the time and in the manner provided in the relevant Sections of this Article.

(6) Agree to terminate City employment upon completion of the designated DROP participation period.

(7) Execute such waivers with respect to age and other discrimination in employment laws as are required by the City and the Retirement System.

SEC. 24.1403 Termination of DROP Participation

a. DROP participation may be terminated by voluntary termination of employment at any time before the completion of the DROP participation period designated by the Member on the appropriate DROP participation form .

b. DROP shall be terminated by the first occurrence of any one of the following events:

(1) upon the completion of the DROP participation period designated by the Member on the appropriate DROP participation form.

(2) involuntary termination of employment. In the event a termination for cause is reversed, a Member's participation in DROP, less any benefits previously distributed pursuant to Section 24.1407, shall be reinstated for the duration of the original DROP participation period initially designated by the Member on the appropriate DROP participation form..

(3) death of the Member..

(4) approval of disability retirement benefits under the terms of this article.

SEC. 24.1404 DROP Benefits and Participation Accounts

a. A DROP Participation Account is a "nominal" account established within the Retirement System on behalf of each DROP participant. All benefits accrued pursuant to this Division shall be accounted for in the DROP Participation Account. A DROP participant shall not have a claim on the assets of the Retirement System with respect to his or her DROP Participation Account, nor shall there be any assets set aside for any DROP participant which are separate from all other Retirement System assets.

b. All amounts credited to the member's DROP Participation Account shall be fully vested.

c. A Member's DROP Participation Account shall be credited with:

(1) an amount, credited monthly, which is calculated in the same manner as a service retirement benefit using the factors for age, service, and final compensation in effect on the effective date of DROP participation. This

amount shall be increased annually pursuant to the COLA provisions described in Section 24.0531.

(2) an amount, credited annually, representing the Annual Supplemental Benefit described in Section 24.0404 based upon the Member's Creditable Service on the day before the Member elects to participate in DROP.

(3) an amount, credited bi-weekly at the end of each pay period, equal to 3.05 % of the Member's compensation earnable.

(4) an amount, deducted from the Members's salary and credited bi-weekly at the end of each pay period, equal to 3.05 % of the Member's compensation earnable. This amount shall be picked up and paid by the City for the sole purpose of obtaining tax deferral and in accordance with the requirements of Internal Revenue Code Section 414 (h) (2).

(5) an amount, representing interest, the rate and manner of crediting to be determined by the Board through rules and regulations adopted pursuant to Section 24.0901. These rules and regulations shall have the same force and effect as a duly adopted ordinance.

SEC. 24.1405 Additional DROP Provisions

a. Effective on the date that a member elects to participate in DROP, employee and employer contributions pursuant to Divisions 2, 3 and 8 of this Article shall cease with respect to that Member.

b. A Member who elects to participate in DROP and becomes disabled during the period of DROP participation shall be eligible to apply for

disability retirement benefits. In the event the application for disability retirement benefits is approved by the Board:

(1) the disability retirement benefit shall be calculated using the factors of age, service, and final compensation in effect the day before the effective date of DROP participation.

(2) all amounts in the Member's DROP Participation Account shall be distributed pursuant to Section 24.1407.

c. In the event a Member dies during the period of DROP participation, eligible survivors shall be entitled to receive:

(1) all amounts in the Member's DROP Participation Account pursuant to Section 24.1407, including the retiree death benefit in Section 24.0714.1.

(2) if eligible, a Special Death Benefit pursuant to Sections 24.0705, 24.0706, 24.0709, 24.0710, 24.0710.1, 24.0710.2, and 24.0710.3 using the factors of age, service and final compensation in effect on the date of the Member's death. The Special Death Benefit shall be paid in lieu of any survivor continuance otherwise payable in the form of benefit determined pursuant to Section 24.1404 (c) (1).

(3) if ineligible for a Special Death Benefit, the designated beneficiary shall only be entitled to the amount and form of benefit determined pursuant to Section 24.1404 (c) (1) in accordance with the Member's designation at the time of DROP election.

d. A Member who elects to participate in DROP shall qualify as a Health Eligible Retiree and be eligible to receive Post Retirement Health Benefits pursuant to Division 12 upon completion of the period of DROP participation and separation from City service..

SEC. 24.1406 Designation of Beneficiary

a. A Member who elects to participate in DROP shall designate a beneficiary. Member's beneficiary designation shall be applicable to all distributions pursuant to Section 24.1407.

b. If the designated beneficiary predeceases a DROP participant who then dies before designating a new beneficiary, all distributions pursuant to Section 24.1407 shall be made to the estate of the DROP participant.

c. No beneficiary designation made under this Section shall be in abrogation of a Member's community property obligations under applicable California law.

SEC. 24.1407 Payment of Benefits

a. Upon the simultaneous termination of DROP participation and City employment, a Member shall be entitled to receive:

(1) the monthly retirement allowance in the amount determined under Section 24.1404(c) (1) that was credited monthly to the Member's DROP Participation Account at the date of termination of DROP participation; and

(2) the amount for which the Member is eligible under the Annual Supplemental Benefit described in Section 24.0404 based upon the Member's Creditable Service on the day before the Member's election to participate in DROP.

(3) All amounts credited to the Member's DROP Participation Account on the effective date of termination of DROP participation.

b. The normal form of payment shall be a lump sum distribution, provided, however, a Member may elect to receive an annuity pursuant to this Section. If the Member elects to receive an annuity:

(1) the annuity shall be in any form established by the Board and subject to applicable provisions of the Internal Revenue Code.

(2) the annuity shall be the actuarial equivalent of the amount credited to the DROP Participation Account at the termination of the DROP participation period. For this purpose, "actuarial equivalent" is an amount that has the same present value as the amount credited to the DROP Participation Account at the termination of the DROP participation period based on interest rates and mortality tables recommended by the System's actuary and adopted by

the Board as a part of rules and regulations pursuant to Section 24.0901. The annuity shall be calculated using the age of the DROP participant and, if a joint and survivor option is elected, the age of the beneficiary on the date of termination of the DROP participation period.

c. No COLA or supplemental benefit or later adjustment shall be made with respect to any annuity payable pursuant to Section 24.1407 (b).

SEC. 24.1408 Compliance with Applicable Provisions of the Internal Revenue Code.

a. It is intended DROP shall not jeopardize in any way the tax qualified status of the Retirement System under the rules and regulations of the Internal Revenue Service. The Board shall have the authority pursuant to Section 24.0901 to adopt rules and regulations to the extent necessary or appropriate for DROP to comply with applicable Federal laws and regulations, with such action having the same force and effect as a duly enacted ordinance.

b. Notwithstanding any other provision in this Article, benefits provided pursuant to this Division shall be subject to the requirements of the Internal Revenue Code (Code) and regulations issued thereunder as necessary for the Retirement System to remain a tax qualified retirement plan, including, but not limited to, the following:

(1) The limitations of Section 415 of the Code relating to the amount of benefits that can be paid.

(2) The limitations of Section 401 (a) (17) of the Code relating to the amount of compensation that can be taken into account for benefit accrual.

(3) The limitations of Section 401 (a) (9) relating to the time that benefit payments must begin.

(4) The limitations of Section 401 (a) (31) relating to the rollover of benefits.

(5) The limitations of Section 401 (a) (25) relating "definitely determinable" benefits.

SEC. 24.1409 Employment Status during DROP Participation

A Member who elects to participate in DROP shall have all of the rights, privileges, and benefits, and be subject to all other terms and conditions of active employment, including, but not limited to, the City Flexible Benefits Plan.

Section 24. That Chapter II, Article 4, Division 8, of the San Diego Municipal Code be and the same is hereby amended by amending Section 24.0801, to read as follows:

SEC. 24.0801 City's Contribution

Commencing July 1, 1954 the City shall contribute to the Retirement Fund in respect to members a percentage of earnable compensation as determined by the System's Actuary pursuant to the annual actuarial evaluation required by Section 24.0901. The required City contributions shall be determined separately by the Actuary for General Members and Safety Members.

All deficiencies which may accrue as a result of the adoption of any section in the Retirement Ordinances must be amortized over a period of thirty years or less. Any amount designated pursuant to Section 24.1203(b)(5) shall not constitute a deficiency within the meaning of this Section.

Section 25. The benefit improvements shall not become effective unless approved by the active members of the Retirement System. The Retirement Administrator is directed to immediately inform the City Clerk of the results of the vote held pursuant to Charter section 143.1. The San Diego Municipal Code shall not be amended pursuant to this ordinance unless and until the Retirement Administrator notifies the City Clerk the members of the Retirement System have approved the increase on benefits.

Section 26. For purposes of establishing a referendum only, this ordinance shall take effect and be in force on the thirtieth day from and after its passage.

APPROVED: CASEY GWINN, City Attorney

By Sharon A. Marshall
Sharon A. Marshall
Deputy City Attorney

LEC:SAM:mrh

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EXHIBIT 3



CITY OF SAN DIEGO

8/98

DEFERRED RETIREMENT OPTION PLAN (DROP)

- I. PURPOSE and DURATION.
 - A. **Voluntary** alternative method of benefit accrual
 - B. Allows accumulation of **lump sum benefit** in addition to monthly retirement allowance
 - C. Initially offered on a **3-year trial basis** (beginning 4/1/97)
City will evaluate whether there is a impact on employer rates which is greater than savings to employer
- II. PARTICIPATION in DROP.
 - A. Upon reaching **earliest age/service requirement** eligibility:
(Safety Members = 20 years at age 50 or 10 years at age 55)
(General Members = 20 years at age 55 or 10 years at age 62)
 - B. **Voluntary and irrevocable** election to participate in DROP
(employee executes waivers re: discrimination)
 - C. Up to **maximum of 5 years** participation--then terminate
 - D. Monthly **annuity** calculated on effective date of DROP
 - E. Annuity deposited into interest bearing DROP account
- III. TERMINATION of DROP. DROP participation may be terminated:
 - A. **Voluntary termination** of employment by employee
 - B. **Involuntary termination** of the employee
 - C. **Death** of the member
 - D. Approval of a **disability retirement**
- IV. DROP ACCOUNT.
 - A. Individual member's account is **within the assets of the System**
 - B. **No access** to account by employee during employment
 - C. Account credited monthly with: (i) **normal annuity**; (ii) **3.05%** of salary from **employer**; (iii) **3.05% of salary** deduced from **employee salary**; (iv) **interest** as determined by the Board
- V. PAYMENT OF BENEFIT. Upon termination, member shall receive:
 - A. Continuation of monthly annuity calculated at **beginning of DROP** and
 - B. **All monies in DROP account**; (i) as a lump sum or (ii) as an annuity

EXHIBIT 4

CLOSED SESSION REPORT ☒ CITY OF SAN DIEGO ☐ OTHER (See below)

NOT A PUBLIC RECORD

until the information in this box is completed,
signed by an authorized representative of the
City Attorney's Office and stamped in the space below

TITLE Conference with Labor Negotiator - Meet and Confer
[salary proposals] (DCA Marshall)

DATE OF CLOSED SESSION: 3/21, 2000

Date Litigation Concluded: _____, 2000

By: _____

Title: _____

(STAMP HERE)

☐ **REAL PROPERTY NEGOTIATIONS** G.C. § 54956.8

☐ Ongoing/Status Report

☐ Final Approval of Agreement (D)

Substance of Agreement: _____

☐ Final approval dependent on other party

☐ **LITIGATION** G.C. § 54956.9

☐ (a) Pending ☐ (b)(1) Significant Exposure ☐ (b)(2) Authorizing Session ☐ (c) Initiating

☐ Defend Litigation (D)

☐ Status Report

☐ Seek Appellate Review (D)

☐ Refrain from Seeking Appellate Review (D)

☐ Amicus Participation

☐ Other (see below)

☐ Settlement Offer To Be Conveyed

☐ Acceptance of Signed Settlement Offer (D)

☐ Initiate Litigation or Intervene (D)

☐ Contingent Acceptance of Signed Offer

☐ Non-Disclosure of Litigation Recommended (check if yes):

☐ Interfere with service of process ☐ Impair ability to settle

Full Case Name: _____

Case Number: _____

Substance of Agreement: _____

☐ **CLAIMS DISPOSITION** G.C. § 54956.95

☐ Offer Made

☐ Offer Accepted

Claimant: _____

Substance of Claim: _____ Amount: _____

☐ **DECISION ON EMPLOYMENT STATUS** G.C. § 54957

☐ Appoint (D)

☐ Employ (D)

☐ Accept Resignation (D)

☐ Discipline (D)

☐ Dismissal or Nonrenewal (disclose after exhaustion of administrative remedies)

Title: _____ Change in Compensation: _____

☒ **LABOR NEGOTIATIONS** G.C. § 54957.6

☐ Ongoing/Status Report

☒ Final Approval of Agreement (D) Other Party to Negotiation: _____

Item Approved: POA 2-yr MOU; 2% 7/00, 5% 7/01, plus benefits and wage adjustments

☒ **VOTE**

☐ NO VOTE NECESSARY

COMMENTS: Discussion regarding parity for other 3 unions; vote also

Name	Aye	No	Absent
District 1	X		
District 2	X		
District 3	X		
District 4	X		
District 5	X		
District 6	X		
District 7	X		
District 8			X
Mayor			X
Voting Tally	7	0	2

_____ to take no action to terminate DROP _____

APPROVED: _____

NOTE: (D) DISCLOSE FOLLOWING CLOSED SESSION

**CITY OF SAN DIEGO, CALIFORNIA
COUNCIL CLOSED SESSION MINUTES
TUESDAY, MARCH 21, 2000
(2:10 p.m. - 4:19 p.m.)**

ATTENDANCE:

COUNCIL

Golding <u>NP</u>	Kehoe <u>X</u>	Stallings <u>X</u>
Mathis <u>X</u>	Stevens <u>2:21</u>	McCarty <u>X</u>
Wear <u>X</u>	Warden <u>2:27</u>	Vargas <u>2:26</u>

CITY MANAGER STAFF

Uberuaga, Herring, Belock, Frazier, Schlessinger, McGhee, Kelley, Griffith.

CITY ATTORNEY STAFF

Girard, Bromfield, McAteer, Salt, Stiffler, Mittlestadt.

CITY AUDITOR STAFF

Ryan, Webster.

CITY CLERK STAFF

Abdelnour, Maland, Woronicz.

SUBJECT #1:

II. Conference with Legal Counsel - anticipated litigation - significant exposure to litigation, pursuant to California Government Code Section 54956.9(b):

**b. Regional Water Quality Control Board v. City of San Diego.
Notice of Violation 00-46**

Deputy City Attorney Bromfield briefed Council on the background of the case and asked for the City Council's approval offering and recommending a two-step process to expedite the repair of the Alvarado Trunk Sewer: 1) Let the City Manager, through the use of the JOC (Job Order Contract) of Balboa, begin the relocation; and 2) with the City Council's approval, have the City Attorney bring back an emergency ordinance to open session on April 10th to get the appropriate funds to fund this.

Discussion was held regarding the case.

ACTION: **MOTION BY WEAR TO APPROVE STAFF'S
RECOMMENDATION. Second by Stallings. Vote:
Unanimous; 4,5,8,M-not present.**

SUBJECTS #2:

III. Conference with Labor Negotiator, pursuant to Government Code Section 54957.6:

Agency negotiators: **Michael Uberuaga, Bruce Herring, Dan Kelley,
Stanley Griffith, Mike McGhee**

Employee organizations: **Municipal Employees Association, Local 127
AFSME, AFL-CIO, Local 145 International
Association of Firefighters AFL-CIO, San Diego
Police Officers Association.**

ACTION: This item was discussed.

I. Conference with Legal Counsel-existing litigation, pursuant to California Government Code Section 54956.9(a):

- g. Corbett, et al. v. City Employee Retirement System
S.D. Superior 722449.**

Deputy City Manager Herring briefed Council with an informational presentation on this case.

ACTION: **Information Item Only. No action taken.**

Deferred Retirement Option Program "DROP"

- Established by Municipal Code Section 24.1401 in 1997
 - DROP implemented on a three year trial basis
 - If the City determines DROP to be cost effective, or takes no action to eliminate DROP participation, DROP shall become a permanent benefit effective April 1, 2000
-

DROP Employee Benefits

- Allows an employee to enter a deferred retirement plan yet continue City employment
 - ▶ Employee receives regular paychecks and benefits while in DROP
 - ▶ Employee receives deferred pension check which is invested within the CERS at a rate of 8% per annum.
 - ▶ An employee can remain in DROP for a maximum of five (5) years
-

DROP City Benefits

- DROP benefits the City

- ▶ No further actuarial contribution required to CERS
- ▶ \$4.0M savings since inception of DROP
- ▶ Skilled and experienced employees remain on the job allowing for smooth transition through phased retirement

DROP by the Numbers

- DROP participants

- ▶ 136 Police
- ▶ 146 Fire & Life Safety
- ▶ 179 General Members

461 Total participants

DROP by the Numbers

- City Budget Implications
 - ▶ \$1.30M FY 1999 Savings
 - ▶ \$1.32M FY 2000 Savings
 - ▶ \$1.38M FY 2001 Savings

DROP by the Numbers

- CERS Actuary cites need for further evaluation of data over period of year to draw firm conclusions on savings/costs
- General Fund saved \$4.0M since inception
- Retirement system absorbed \$4.2M in actuarial impact since inception

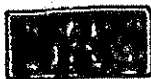
Recommendations

- Continue DROP
- Direct Staff to provide Council with a 5 year evaluation of the DROP program through 2002 focusing on:
 - ▶ Fiscal impact to City
 - ▶ Actuarial impact on CERS
 - ▶ Staffing and turnover implications

Mileage Reimbursement

- MEA has requested relief due to:
 - ▶ Soaring prices at the pump
 - ▶ 48% increase over March 1999
 - ▶ Average price per gallon is currently \$1.74

EXHIBIT 5



GABRIEL, ROEDER, SMITH & COMPANY
Consultants & Actuaries

9171 Towne Centre Drive • Suite 440 • San Diego, California 92122 • 619-535-1300 • FAX 619-535-1415

June 22, 1999

Mr. Larry Grissom
City of San Diego Employees' Retirement Association
401 B Street, Suite 400
San Diego, CA 92101

Dear Larry,

We have enclosed a second draft of DROP's financial impact. We are asking you to take a careful look at Items 1 and 2. Item #2 was not included in our initial draft. Neither was newly added Item #6.

Our thought is to keep this in draft form for the time being until there comes a point where we have beaten the subject to death internally and we feel that outside sources of sage advice on this matter have been exhausted.

We will fax a copy of this to Karen Steffen and ask if she has any input.

Of course, if there is some point prior to early next year where you wish wide distribution of this, just let us know and we will finalize.

Enclosed is a bill.

Sincerely,

Rick A. Roeder, EA, FSA, MAAA



0489-0001



Evaluating the Financial Impact of DROP
City of San Diego

June 17, 1999
(Second Draft)

We appreciated the exploratory meeting on June 9 to discuss the most equitable manner to determine how DROP impacts System costs. Your input was instrumental in us adding Item #6. With the benefit of added thought, we have also added Item #2 since valuation assets do change to reflect the newly created DROP reserve. We also have made a minor modification to the reflection of accrued liabilities to reflect the 1.6% COLA that was applied as of July 1 in some of our calculations.

We have tried to isolate the impact of the DROP program on the change in the calculated actuarial rate for the 1998 valuation. We initiated this because of our efforts to reconcile the difference between the 1997 and 1998 contribution rates. We are asking for input because of the complexity surrounding these calculations and the political sensitivity due to the DROP program's interim status.

There are two basic ways that DROP service can be reflected in actuarial computations:

1. Treat the DROP recipients as retirants at the point that they elect to DROP.
2. Treat the DROP recipients as actives for an average assumed period beyond their DROP date.

In the City of San Diego valuation, we are using Method #1 and treating the DROP recipients as retirants. Our rationale is based on the adage that if it "walks like a duck and looks like a duck, it probably is a duck."

Retirants do not pay plan contributions. Neither do DROP recipients (there is a 3.05% employer credit that relates to the City's defined contribution program). Active members do pay plan contributions.

DROP recipients, like retirants, do not accrue further benefits. Active members do.

The actuarial auditor suggests use of Method #2 if the DROP program gets beyond its current probationary period. If they were based in Oregon, instead of Seattle, perhaps they would believe in ducks. Method #2 is reasonable in that it spreads the normal cost over anticipated DROP service, thereby reducing the normal cost relative to #1 in most cases.

Method #1 will generally produce a higher normal cost rate and higher accrued liabilities than Method #2. However, the normal cost rate will apply to a lower payroll amount. Thus, it would be difficult to generalize as to which approach produces a higher contribution. As a practical matter, Method #2 would be difficult to implement until there is a pretty good idea as to what average DROP service will be. Under the City's Projected Unit Credit Method, these employees would be treated very similar to retirees anyway, since the normal cost is based on the next year's projected accrual. For DROP's, this would be negligible.

As our starting point, we first looked at DROP recipients as retirants and valued a liability associated with their retired status. We based on our calculations on the average demographic included in the report.

	<u>Number</u>	<u>Annual Allowance</u>	<u>Retirement Age</u>	<u>Attained Age</u>	<u>Years of Credited Service</u>
General	60	\$32,056	59.4	60.0	30.1
Police	61	\$47,223	54.0	54.7	27.0
Fire	93	\$51,352	54.3	55.2	28.7

0489-0002



We calculated the Final Average Compensation associated with these demographics. We then worked up related numbers based on the average annual overall pay increase of 3.7% for active members in 1997-98.

	<u>Final Average Compensation</u>	<u>Related Compensation At Retirement</u>	<u>Estimated Compensation At 6/30/98</u>
General	\$49,731	\$50,650	\$51,575
Police	\$59,360	\$60,450	\$62,000
Fire	\$60,167	\$61,250	\$63,300

From these assumptions, we estimate costs/savings with DROP using four elements. In our calculations, we assumed that Safety members were male and that 50% of General members are female.

To date, we have identified six areas of cost or savings to the City due to the implementation of the DROP program.

1. We first estimate the aggregate accrued liability for future benefit payments as a DROP recipient (and therefore value as a retiree). We then value accrued liabilities for the same hypothetical member had they instead continued as an active member, continuing to accrue service credit, at the valuation date. Then we compare accrued liabilities between the two calculations. One of the tricky elements is that some of the DROP's would have retired by the valuation date even if DROP did not exist. The valuation assumes that 20% of Safety members at age 54 will retire during the next year and that 15% of General members age 59 will retire in the next year.

	<u>Active (1)</u>	<u>Retiree (2)</u>	<u>Difference (3)</u>	<u>Expected Active At Valn Date (4)</u>	<u>Active Liability Increase ((1)-(2))*(4)</u>
General	\$428,600	\$424,600	\$4,000	54.6	\$218,400
Police	\$666,300	\$666,800	\$ (500)	52.5	\$ (26,250)
Fire	\$707,200	\$720,800	(\$13,600)	76.3	(\$1,037,700)
Total					\$ (845,550)

The total liability difference is then amortized over 23 years (15.43 factor), applied to compensation and then converted to an equivalent, beginning-of-year rate differential. The impact of DROP also results in lower covered payroll. This year's dollar cost to amortize the unfunded liability increase is roughly \$52,700, or roughly 0.01% of City payroll.

Since the active accrued liability is less than the related retiree accrued liability, there is a net cost to the City. There would have been a net savings to the City if the active accrued liabilities were greater than related retiree liabilities. While it is a cost item this year, it could be a savings item in some future years.

For this purpose, it is unclear whether the total liability increase or only this year's portion of the amortized increase should be shown as a savings. In our total, we have shown only the amortized portion as a savings since this analysis isolates on the 1999 fiscal year. We have a preference for the entire accrued liability differential to be shown. Otherwise, a particular year's savings or cost due to this item would be at the mercy as to the somewhat arbitrary element of the length of the remaining amortization period.

0489-0003



2. A DROP reserve of \$8,826,738 was in existence as of the valuation date. This was excluded from valuation assets since the liabilities that we explicitly value for DROP recipients are only for prospective payments from the valuation date. This reduction of valuation assets increases the amortization cost of unfunded liabilities to the System. The System has a liability to pay for "accrued" payments for DROP recipients in addition to payments valued in Item #1.

To simply amortize the entire DROP reserve would be to overstate DROP's impact since some would have retired in any event even in absence of DROP. We used the relative amount of retiree accrued liabilities and assumed retirement patterns in Item #1 in deriving the portion of the DROP reserve that should be ignored, as follows:

	<u>Retiree Liability</u> (1)	<u>DROP Retirees</u> (2)	<u>DROP Liability</u> (1) * (2)	<u>Expected Active At Valn Date</u> (4)	<u>Expected Active Liability</u> (1)*(4)
General	\$424,600	60	\$25,476,000	54.6	\$23,183,160
Police	\$666,800	61	40,674,800	52.5	\$35,007,000
Fire	\$720,800	93	67,034,400	76.3	\$54,997,040
Total			133,185,200		\$113,187,200

The difference between the 113.2 and 133.2 million dollar figures reflect the "attrition" from active member liabilities for those who would have been expected to retire in a non-DROP environment. If we take the 85% ratio between these two numbers and apply 85% to the DROP reserve, we derive a figure of \$7,501,000. This is the estimate of the added liability due to accrued pension payments caused by DROP.

The amortized related impact on the 1998 contribution would be roughly 0.12% of City payroll.

3. There are fewer dollars being contributed by the City because DROPs are classified as retirants. This represents a cost savings to the City. We have assumed that an additional 20% of General members and 40% of Safety members would retire during the year in accordance with assumed probabilities at ages 60 and 55, respectively.

	<u>Expected Actives At Valn Date</u>	<u>"Weighted" Actives</u>	<u>Avg. Normal Cost For DROP Member</u>	<u>1999 FY Normal Cost Savings</u>
General	54.6	49.1	\$11,600	\$569,550
Police	52.5	41.8	\$14,500	\$606,100
Fire	76.3	61.0	\$14,250	\$869,250
Total				\$2,044,900

In calculating the savings, we think that there is a good argument to use expected actives at the valuation date instead of weighted employees since there will be some new DROPs during the plan year (although significantly less than the first year). The total savings would increase to \$2,482,000 based on anticipated employees at the beginning of the year instead of "weighted" employees.



4. The System loses contribution inflows from those DROP members who otherwise would have been projected to be active members. This represents a loss to the City.

	Actives Beginning Of Year (1)	"Weighted" Actives (2)	Entry Age Rate (3)	Compensation (4)	FY 1999 Contribution Loss (2) * (3) * (4)
General	54.6	49.1	8.98%	\$52,400	\$231,000
Police	52.5	41.8	12.29%	\$63,000	\$323,600
Fire	76.3	61.0	11.70%	\$64,300	\$458,900
Total					\$1,013,500

The contribution loss would instead be \$1,237,400 if based on projected actives, if DROP did not exist, as of July 1, 1998.

This net savings to the City of Item #2 less Item #3 does not directly translate into a lower contribution rate. However, if the total savings is applied against \$399 million of City valuation payroll, and netted for "forgone" employee contributions, this effectively reduces the rate by 0.26% - 0.31% of valuation payroll.

5. There are pick up savings due to the lack of pick up on behalf of DROP members. This saves the City money.

	Actives Beginning Of Year (1)	"Weighted" Actives (2)	Net Pick Up Rate (3)	Compensation (4)	1999 FY Savings (2) * (3) * (4)
General	54.6	49.1	5.1%	\$52,400	\$131,200
Police	52.5	41.8	5.7%	\$63,000	\$150,100
Fire	76.3	61.0	5.7%	\$64,300	\$223,600
Total					\$504,900

The pick up rate is netted for "anticipated"(!) refund savings of 22% and 7%, respectively, for Safety and General members.

If actives as of July 1, 1998 are instead used, the pick up savings increases to \$614,100.

6. The accounts of DROP participants are credited at a rate of 8% per annum, compounded quarterly. This translates into an effective rate of 8.24% per annum. If fund earnings exceed 8.24% in a given year, there will be a savings to the City; if not, a cost.



THE ONE-YEAR METHOD

If we solely isolate on the impact on the current year contribution rate, we derive the

	<u>Weighted Employee Approach</u>	<u>Beginning Of Year Approach</u>	
Item #1	\$52,700	\$52,700	Savings
Item #2	468,000	468,000	Cost
Item #3	2,044,900	2,482,000	Savings
Item #4	1,013,500	1,237,400	Cost
Item #5	504,900	614,100	Savings
Item #6	??	??	
Total	\$1,121,000	\$1,443,400	Savings Prior To Item #6

We have a slight, theoretical preference for the \$1,443,400 figure which reflects actual active members at the beginning of the year.

THE TOTAL IMPACT METHOD

This method calculates the all estimated impact, including that for future years, on each element of cost or savings. We believe this is a technical improvement over the one-year method. Under the one-year method, changes in accrued liability are amortized over the remainder of the amortization period (23 years as of June 30, 1998). The normal cost changes reflect expected future working lifetime for the covered DROP group, which will usually be one to three years. These time frames are clear mismatches. Thus, the total impact looks at the total value of cost or savings, on a present value basis, for the current year and all estimated future years where this year's DROP activity is projected to have some impact.

	<u>Weighted Employee Approach</u>	<u>Beginning Of Year Approach</u>	
Item #1	\$845,550	845,550	Savings
Item #2	\$7,501,000	7,501,000	Cost
Item #3	3,909,100	4,700,500	Savings
Item #4	1,898,500	2,298,700	Cost
Item #5	958,050	1,154,900	Savings
Item #6	??	??	
Total	\$3,686,800	\$3,098,750	Cost Prior To Item #6

Is it an anomaly that there is a net cost of Items 1-5 under the Total Impact Method but a savings under the One-year method? No. The biggest Item is #2. The 23-year amortization of the cost under the One-year method spreads out the impact of Item #2 over a long period whereas it is fully reflected in the Total Impact Method.

CAVEATS: An actuary without a caveat is like a sunrise without a rooster. We have two. First, the retirement rates we have been using are largely based on non-DROP experience. DROP may cause a significant impact and make these rates outmoded. We are on record as recommending that Safety members who have attained age 55 and have 30+ years of service are much more likely to retire than indicated by existing retirement assumptions.



Second, using averages is dangerous. The example of a man who drowned in a river with an average depth of three feet comes to mind. In our calculation of the normal cost, we have assumed that every Safety member, who would have remained active, accrues a benefit increase that is much higher than would occur in a number of cases. Why? Because we use an average of 27.0 years and 28.7 years of service, respectively, for Police and Fire members at the time they DROP. Notwithstanding, there will be a significant minority of DROPs who will have reached the 90% maximum benefit when they DROP because of the dual attainment of 55 & 30. If desired, we can refine this approximation. Because of this, our best judgement is that the City's normal cost savings in Item #3 is overstated.



San Diego City Employees' Retirement System
Retirants and Beneficiaries June 30, 1996
Tabulated by Attained Ages and Year of Retirement

General Members

Year Retired	Age Groups								Totals
	0-49	50-59	60-64	65-69	70-74	75-79	80-89	90+	
Before 1977	5	14	9	9	33	64	301	73	508
1977	3	7	2	7	8	34	60	0	121
1978	0	2	2	2	8	20	62	0	96
1979	1	2	3	2	16	29	59	1	113
1980	3	0	5	2	29	30	25	1	95
1981	2	10	1	8	23	46	21	0	111
1982	1	4	2	3	28	37	18	0	93
1983	0	3	1	1	26	58	9	0	98
1984	4	5	3	7	31	53	10	0	113
1985	7	1	7	10	31	39	13	0	108
1986	1	4	3	17	34	29	4	0	92
1987	4	3	0	28	28	30	3	0	96
1988	5	8	4	25	46	10	2	0	100
1989	3	3	11	27	62	4	3	0	113
1990	1	5	18	31	40	6	5	0	106
1991	6	2	21	46	21	2	1	0	99
1992	5	4	21	30	21	4	0	0	85
1993	9	13	42	55	32	5	0	0	156
1994	12	15	6	24	4	1	2	1	65
1995	15	13	29	28	1	2	0	0	88
1996	<u>8</u>	<u>22</u>	<u>26</u>	<u>12</u>	<u>3</u>	<u>0</u>	<u>1</u>	<u>0</u>	<u>72</u>
Totals	95	140	216	374	525	503	599	76	2,528

Age at Retirement: 59.0 years
Attained Age: 71.7 years
Annual Pension: \$10,308

0489-0008



San Diego City Employees' Retirement System
Retirants and Beneficiaries June 30, 1996
Tabulated by Attained Ages and Year of Retirement

Safety Members

Year Retired	Age Groups								Totals
	0-49	50-59	60-64	65-69	70-74	75-79	80-89	90+	
Before 1977	9	44	21	42	53	117	169	34	489
1977	10	20	8	2	18	11	2	1	72
1978	7	23	3	3	8	13	2	0	59
1979	5	16	8	8	17	2	4	1	61
1980	8	18	2	18	8	0	1	0	55
1981	7	10	5	6	8	5	2	1	44
1982	2	9	1	12	5	0	1	0	30
1983	4	8	5	11	13	2	1	0	44
1984	3	5	9	14	3	1	1	0	36
1985	12	4	3	13	1	1	0	0	34
1986	5	14	9	14	2	0	0	0	44
1987	6	6	10	7	4	0	0	0	33
1988	6	10	9	8	0	0	0	0	33
1989	8	26	16	5	1	0	0	0	56
1990	17	17	15	2	0	0	0	0	51
1991	14	11	23	2	0	0	0	0	50
1992	13	20	9	0	0	0	0	0	42
1993	26	76	47	3	1	1	0	0	154
1994	26	13	1	0	0	0	0	0	40
1995	16	27	1	0	0	0	0	0	44
1996	18	28	5	1	0	0	1	0	53
Totals	222	405	210	171	142	153	184	37	1,524

While not used in the financial computations, the following group averages are computed and shown because of their general interest.

Age at Retirement: 47.5 years
Attained Age: 63.1 years
Annual Pension: \$21,107



San Diego City Employees' Retirement System
Summary of Retired Members and Beneficiaries Included
in the June 30, 1998 Actuarial Valuation

The following include DROP Retirements.

	<u>No.</u>	<u>Annual Allowance</u>	<u>Annual Allowance</u>	<u>Averages</u>		<u>Service at¹ Retirement</u>	<u>New Retirees</u>		
				<u>Attained Age</u>	<u>Age at¹ Retirement</u>		<u>No.</u>	<u>Age</u>	<u>Allowance</u>
General Members									
6/30/97	2,548	\$27,698,098	\$10,871	72.0	58.9	20.6	71	58.5	\$23,256
6/30/98	2,661	32,176,333	12,092	71.7	58.6	21.1	143	58.8	25,920
Percent Increase	4.4%	16.2%	11.2%						
Safety Members									
6/30/97	1,575	34,974,007	22,206	63.4	47.8	20.2	58	50.4	\$38,552
6/30/98	1,758	44,330,848	25,217	63.1	48.3	20.9	98	52.5	44,910
Percent Increase	11.6%	26.7%	13.6%						
Grand Total 6/30/97	4,123	\$62,672,105	\$33,077	68.7	54.6	20.2	138	55.2	\$29,196
Grand Total 6/30/98	4,419	76,507,181	37,309	68.3	54.5	20.8	265	56.6	33,402
Percent Increase	7.2%	22.2%	14.0%						

¹ Retirees only; beneficiaries excluded.

0489-0010



San Diego City Employees' Retirement System
Summary of Retired Members and Beneficiaries Included
in the June 30, 1998 Actuarial Valuation

(Continued)

	<u>No.</u>	<u>Annual Allowance</u>	<u>DROP Averages</u>				<u>New DROPS</u>	
			<u>Annual Allowance</u>	<u>Attained Age</u>	<u>Age at ¹ Retirement</u>	<u>Service at ¹ Retirement</u>	<u>No.</u>	<u>Annual Allowance</u>
General 6/30/98	60	\$1,923,349	\$32,056	60.0	59.4	30.1	45	\$29,742
Police 6/30/98	61	2,880,601	47,223	54.7	54.0	27.0	39	43,532
Fire 6/30/98	93	4,775,714	51,352	55.2	54.3	28.7	31	51,373
Grand Total 6/30/98	214	\$9,579,665	\$44,765	56.4	55.6	28.6	115	\$40,250

¹ Retirees only; beneficiaries excluded.

0489-0011



San Diego City Employees' Retirement System
Summary of Retired Members and Beneficiaries Included
in the June 30, 1999 Actuarial Valuation

The following include DROP Retirements.

	<u>No.</u>	<u>Annual Allowance</u>	<u>Averages</u>			<u>Service at¹ Retirement</u>	<u>New Retirees</u>		
			<u>Annual Allowance</u>	<u>Attained Age</u>	<u>Age at¹ Retirement</u>		<u>No.</u>	<u>Age</u>	<u>Allowance</u>
General Members									
6/30/99	2,773	\$36,449,808	\$13,145	71.5	58.5	20.9	185	58.8	\$26,757
6/30/98	2,661	32,176,333	12,092	71.7	58.6	21.1	143	58.8	25,920
Percent Increase	4.2%	13.3%	8.7%						
Unified Port District									
6/30/99	232	\$3,777,935	\$16,284	68.5	58.0	16.0	7	55.4	\$16,382
6/30/98	227	3,610,346	15,905	68.7	58.6	16.7	24	60.8	30,997
Percent Increase	2.2%	4.6%	2.4%						
Safety Members									
6/30/99	1,884	51,373,629	27,268	62.8	48.5	20.8	154	52.1	\$46,053
6/30/98	1,758	44,330,848	25,217	63.1	48.3	20.9	98	52.5	44,910
Percent Increase	7.2%	15.9%	8.1%						
Grand Total 6/30/99	4,889	\$91,601,372	\$18,736	68.0	54.6	20.6	326	55.6	\$35,650
Grand Total 6/30/98	4,646	80,117,527	17,244	68.3	54.5	20.8	265	56.6	33,402
Percent Increase	5.2%	14.3%	8.7%						

¹ Retirees only; beneficiaries excluded.

0489-0012



San Diego City Employees' Retirement System
Summary of Retired Members and Beneficiaries Included
in the June 30, 1999 Actuarial Valuation

(Continued)

	<u>No.</u>	<u>Annual Allowance</u>	<u>DROP Averages</u>				<u>New DROPS</u>	
			<u>Annual Allowance</u>	<u>Attained Age</u>	<u>Age at ¹ Retirement</u>	<u>Service at ¹ Retirement</u>	<u>No.</u>	<u>Annual Allowance</u>
DROP General								
6/30/99	101	\$3,103,392	\$30,727	60.0	59.0	29.5	56	\$30,359
6/30/98	80	1,923,349	32,056	60.0	59.4	30.1	45	29,742
Percent Increase	68.3%	61.4%	(4.3%)					
DROP Police								
6/30/99	103	4,929,805	47,862	54.9	53.9	26.1	49	47,917
6/30/98	61	2,880,801	47,223	54.7	54.0	27.0	39	43,532
Percent Increase	68.9%	71.1%	1.4%					
DROP Fire								
6/30/99	111	5,873,047	52,910	55.2	53.9	28.3	38	53,045
6/30/98	93	4,775,714	51,352	55.2	54.3	28.7	31	51,373
Percent Increase	19.4%	23.0%	3.0%					
DROP UPD General								
6/30/99	1	12,692	12,692	58.5	57.8	20.0	1	12,692
DROP Grand Total								
6/30/99	316	\$13,918,936	\$44,047	56.6	55.5	28.0	144	\$42,197
6/30/98	214	9,579,665	44,765	56.4	55.6	28.6	115	40,250
Percent Increase	47.7%	45.3%	(1.6%)					

¹ Retirees only; beneficiaries excluded.

0489-0013



EXHIBIT 6



GABRIEL, ROEDER, SMITH & COMPANY
Consultants & Actuaries

5171 Towne Centre Drive • Suite 440 • San Diego, California 92122 • 619 535-1300 • FAX 619 535-1415

November 18, 1999

Mr. Larry Grissom
City Employees' Retirement System
401 B Street, Suite 400
San Diego, CA 92101-4227

Dear Larry,

We wish to summarize pertinent points from yesterday's conversation on DROP.

In our method of calculating costs and savings associated with DROP earlier this year, one of the costs of DROP would be reduced if the 90% cap on Safety benefits were not considered.

The \$31 million cost under the "total impact" method that we estimated for DROP was for the period from the inception of the DROP program through June 30, 1998. Savings and costs for future DROPs will vary with their number and demographics.

We would caution against drawing firm conclusions about the financial impact of DROP until adequate data is available over a period of years. Thus, experience during the three-year pilot period may not be fully credible.

Sincerely,

Rick A. Roeder, FA, FSA, MAAA

EXHIBIT 7

DROP's "Hidden" Liabilities
September 13, 1999

After our most recent DROP meeting, it became apparent that one technical point is making the concept of DROP murky. The issue relates to the account balance during a participant's DROP period.

In regard to the participant's DROP account, one person said, "What do I care? If it's in a defined contribution account balance, I view it as an entirely separate issue than the funding of the defined benefit plan." Another said, "These monies have already been considered and funded in the process in any event."

Such comments are understandable but untrue. Hopefully, the following example will illustrate.

Let's assume that a firefighter has 30 years of service and is 55 years old. The firefighter elects to work three additional years.

The pension at age 55 is \$40,000 per year. What is the actuarial value of the total benefit due the firefighter ceases providing services at age 58 under both a DROP election and no DROP election?

If the firefighter DROPS:

Part A is their DROP account. We are assuming a 2% annual pension increase. This is determined by:

<u>Pension Amounts</u>		<u>DROP Account Additions</u>	<u>Total</u>
		<u>Credited Interest during 3 years</u>	
Year 1	\$40,000	\$8,486	\$48,486
Year 2	\$40,800	\$4,993	\$45,793
Year 3	\$41,616	\$1,633	\$43,249
Totals	\$122,416	\$15,112	\$137,528

Part B: The actuarial value of future pension payments from the non-DROP pension is:

$$\$42,448 * 13.54 = \$574,746$$

13.54 is an actuarial factor to reflect the present value of future anticipated payments of \$1 per year commencing at age 58.

The sum of Part A and Part B is \$712,274:

Suppose the firefighter does not DROP and still retires at 58. Let's also assume that the firefighter receives a 4.75% pay increase each year during the three-year DROP period.

Whether the firefighter retires at age 55 or age 58, the initial percentage of final pay will remain unchanged at 90%. However the final pay at age 58 is projected to be 14.9% higher than at age 55. Thus, the available \$40,000 pension at age 55 will increase to a pension of \$45,975 starting at age 58.

The actuarial value of this pension is:

$$\$45,975 * 13.54 = \$622,502$$

The value of the DROP alternative is \$89,772 greater than the non-DROP alternative.

Three parting comments: The DROP impact for General members will be less pronounced than Safety members due to their combination of a lower benefit formula and a 100% pension cap (instead of 90%).

Second, if DROP continuance next year is problematic due to cost concerns, one minor plan design "tweak" might be considered: The cost-of-living allowances not be considered during the DROP period and in determining the initial pension after the DROP period.

In Summary: To the extent that DROP impacts the date of retirement, there will be some cost impact.

EXHIBIT 8

CITY OF SAN DIEGO

LABOR RELATIONS OFFICE

202 "C" Street, MS 9A

San Diego, California 92101

(619) 236-6313

(619) 235-5265 (FAX)

DATE: 3/20/2000

TO: Tony Grison

FAX NO. 533-4611

FROM: Dan Kelley
Labor Relations Manager

FAX NO. (619) 235-5265

NO. OF PAGES (including this cover sheet): 4

Drop material for Closed Session.

Can you help with #'s - comments?

DK

**Deferred Retirement Option Program
"DROP"**

- Established by Municipal Code Section 24.1401 in 1997
- DROP implemented on a three year trial basis
- If the City determines DROP to be cost effective, or takes no action to eliminate DROP participation, DROP shall become a permanent benefit effective April 1, 2000

DROP Employee Benefits

- Allows an employee to enter a deferred retirement plan yet continue City employment
 - Employee receives regular paychecks and benefits while in DROP
 - Employee receives deferred pension check which is invested within the CERS at a rate of 8% per annum.
 - An employee can remain in DROP for a maximum of five (5) years.

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DROP City Benefits

- DROP benefits the City
 - No further actuarial contribution required to CERS
 - \$_____ savings since inception of DROP
 - Skilled and experienced employees remain on the job allowing for smooth transition through phased retirement

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Mandatory Review of DROP by City Council

- Municipal Code requires Council review by 3/31/00
- Decision to continue DROP or not.

19

DROP by the Numbers

- DROP participants
 - 136 Police
 - 146 Fire & Life Safety
 - 179 General Members
- 461 Total participants

20

DROP by the Numbers

■ CERS Actuarial Impact

- ▶
- ▶
- ▶

21

DROP by the Numbers

■ Budget Implications

- ▶ \$ K FY 1998 Savings
- ▶ \$ K FY 1999 Savings
- ▶ \$ K FY 2000 Savings
- ▶ \$ K FY 2001 Savings

22

Recommendations

- Continue DROP ~~through 2002 contingent upon fiscal implications to the City and CERS~~
- Direct Staff to provide Council with a 5 year evaluation of the DROP program focusing on:
 - ▶ Fiscal impact to City
 - ▶ Actuarial impact on CERS
 - ▶ Staffing and turnover implications

Through 2002

23

235-5265

EXHIBIT 9

MEA PROPOSAL FOR FY 2001 & FY 2002

This proposal covers all those improvements in wages, hours or other terms and conditions of employment which MEA seeks to achieve in a renegotiated two-year contract covering fiscal years 2001 and 2002, with an expiration date of June 30, 2002.

I. ECONOMIC PROPOSALS WHICH BENEFIT ALL EMPLOYEES

A. General Salary Increase (Article 21)

MEA's commitment as a labor organization to achieving salary increase parity for the employees it represents is unwavering. This means that the same percentage increases in salary which the City has agreed to pay sworn police officers should be paid to the employees in MEA's bargaining units and this is MEA's proposal. Since the "bargaining" has already been done between the City and the POA on this salary increase issue, it is sufficient to say that MEA's "proposal" is to accept the amounts already agreed upon (an additional¹ 2% general salary increase for FY 2001 and a 5% general salary increase for FY 2002), without proposing "more" to get to these amounts through "negotiation" and without any intention of accepting "less" as part of a final settlement.

MEA strongly believes that true salary increase parity should result in the same general salary increase percentage being paid at the same time. However, staggered dates for implementation have been an acceptable aspect of salary increase parity in the past and MEA remains "open" to such an approach for the additional 2% general salary increase in FY 2001 and the 5% general salary increase in FY 2002, assuming that all other aspects of a two-year agreement are resolved satisfactorily.²

¹ It must be remembered that the 2% general salary increase which MEA-represented employees will begin receiving on 7/1/00, is the "same" 2% which police officers have been receiving in their paychecks since 12/26/99. This is the result of the "staggered" implementation dates typically associated with salary increase "parity" whereby MEA-represented employees wait an average of 6 additional months to get the same percentage increase paid to police officers.

² It should also be noted that the City has agreed to a package of economic improvements for Police Officers in a two-year agreement which represents a minimum 8% increase for POIs up to a maximum 9.13% increase for POIs who have an Advanced POST Certificate. For Lieutenants, the minimum increase is 13.88% over two years up to a maximum of 16.45% for those who have an Advanced POST Certificate. Since approximately 1,230 police officers have an Advanced POST Certificate and another approximately 324 have the Intermediate POST Certificate, the value of the 2-year agreement exceeds 8% for the majority of police officers. These numbers do not include increases in Special Assignment Pay.

B. Flexible Benefits Plan (Article 28)

MEA remains committed to the goal of gradually increasing the dollars available to employees for health insurance coverage to an amount which will be sufficient to pay for the cost of dependent health care. Towards this end, each annual increase in the Flexible Benefits Plan dollar value must exceed the amount otherwise necessary merely to keep pace with rising premium costs.

Based on MEA's information regarding increases in health insurance premiums for FY 2001 and FY 2002, MEA proposes that the Flexible Benefits Plan dollar value increase by \$400 on July 1, 2000, and by \$400 on July 1, 2001.

Also, in view of how crucial benefits are to the present and future economic well-being of the employees MEA represents, MEA seeks to clarify in its MOU that MEA has the right (1) to offer to its members other qualified cafeteria plan options through the Flexible Benefits Plan; and (2) to expect the City to fulfill its duty of good faith and fair dealing in all business operations matters affecting the benefit plans MEA sponsors through the cafeteria plan.

C. Holidays (Article 47)

MEA proudly proposes that the City of San Diego--positioned as it is on the border with Mexico and populated as it is with a large Hispanic community--exercise leadership in designating Cesar Chavez' birthday as a paid holiday for City employees (whether the State of California does so or not). In connection with this designation, MEA also proposes that the City join with it in arranging and sponsoring on an annual basis a tribute to Cesar Chavez on or near his birthday in order to educate the community at large about the invaluable contribution Cesar Chavez made during his lifetime in empowering and uplifting farm workers, through non-violent means, and in bringing hope and pride to Hispanic people everywhere. Si se puede!

In addition to adding Cesar Chavez' Birthday as one of the Fixed Holidays identified in section I of Article 47, as a matter of equity with POA, MEA proposes that the following language be added at the end of section I and that Personnel Regulation H-2 be revised accordingly:

If January 1st, July 4th, November 11th, or December 25th fall upon a Sunday, the Monday following is a holiday, and if they fall on a Saturday, the preceding Friday is a holiday. An employee who is eligible for overtime compensation shall receive compensation for the holiday and shall also receive

overtime compensation for all hours worked on the holiday when the employee performs required work on the day on which the holiday falls, not the day the holiday is observed.

D. Retirement (Article 22)

(1) This Article must be revised to reflect the terms of the Class Action Settlement if approved by the court on May 12, 2000.

(2) As a matter of equity, effective July 1, 2000, the City should "pick up" and pay the .4% cost of the "highest one-year" benefit for the employees MEA represents, just as the City has done for firefighters and police officers for several years.

(3) As a matter of equity, effective July 1, 2000, a disability retirement benefit should be available to all employees, just as will be available to police officers, whenever the employee's disability results from a psychological impairment caused by a violent attack upon the employee using deadly force with any dangerous instrumentality.

(4) References to the DROP plan as being offered on a "trial basis" should be eliminated.

II. ECONOMIC PROPOSALS WHICH BENEFIT SOME EMPLOYEES

A. Fair Reimbursement For Required Use Of Personal Vehicles

(1) Modify Article 9, "Personnel Regulations" to include Administrative Regulation 45.10.

(2) Modify Article 38, "Transportation Programs," Section A, "Mileage" to provide a fair reimbursement to employees for required and/or authorized use of personal vehicles.

[Over the past several months, MEA has made a number of written submittals and presentations to the City regarding this issue. MEA intends to submit a comprehensive proposal on this issue to the Management Team at a meeting to be agreed upon.]

B. Special Salary Adjustments (Article 21)

"Special Salary Adjustments" are, of course, just what the name says: adjustments to salary which are "special" because justified for reasons other than cost of living, merit, or general improvement in employees' standard of living.

In connection with the last "meet and confer" process resulting in the current MOU, Management made a clear oral commitment to MEA and the employees it represents that certain special salary adjustments, which the Civil Service Commission had recommended be made in FY 1999, but which Management and/or City Council declined to implement, would be placed at the top of the priority list for consideration in FY 2001. This commitment resulted in the language in Article 21 of our current MOU, which specifically identifies the following: Area Refuse Collection Supervisors, Layout Composers, Zoning Investigators I and II and Senior Zoning Investigators; Police Dispatcher Series and Dispatcher II's in the Police Department.

In addition to these "carry-over" meritorious special salary adjustments, a strong case for other special salary adjustments has also been made.

Therefore, in the context of achieving a satisfactory contract covering FY 2001 and 2002, MEA seeks implementation of the following special salary adjustments on July 1, 2000, in the amounts dates stated below:

Area Refuse Collection Supervisor.....	10%
Collections Investigator II/III.....	25%
Parking Enforcement Officer I/II & Parking Enforcement Supervisor.....	26.7%
Zoning Investigator I/II & Senior.....	15%
Golf Course Superintendent.....	20%
Latent Print Examiner.....	14%
Layout Composer.....	20%
Engineer Series (including Development Project Managers).....	10%
Fire Dispatcher.....	Parity With Police Dispatcher
Police Dispatcher.....	20%
Police Lead Dispatcher.....	25%
Police Dispatch Supervisor.....	25%
Communications Technician Supervisor.....	12.5%
Payroll Audit Supervisor-Auditor.....	5%
<i>Narcotics Evidence & Disposition Specialist.....</i>	<i>10%</i>

C. Special Assignment Pay (Article 21)

Effective July 1, 2000:

(1) All "Special Assignments" currently paid on the basis of a "cents-per-hour" addition to pay shall be converted to a percentage of pay by the same method used for POA.

(2) Modify subsection a to increase Dispatcher Training Pay from 70¢ per hour to 90¢ per hour.

(3) Modify subsection f to increase Dive Team Pay from an additional 5% of base salary to an additional 10% of base salary.

(4) Add a new subsection k for Class B License as follows:

A 50¢ per hour special assignment pay shall be paid to any employee who is directed to obtain a Class B license or who possesses a Class B license and is directed to drive a commercial vehicle requiring the Class B license when the possession of a Class B license is not a minimum requirement for the employee's classification. The special assignment pay shall be paid for each day the employee was directed to and did drive a commercial vehicle. The City shall pay the medical and licensing fees required to obtain the Class B license.

(5) Add a new subsection l for Police Department Dispatchers I and II as follows:

Dispatchers I and II assigned to the Police Department Communications Division shall receive an additional 20% of their base salary.

(6) Add a new subsection m for Community Service Officers as follows:

Community Service Officers assigned to perform Field Training Officer duties shall receive 90¢ per hour while actually functioning in a training capacity.

D. Voluntary Certification Pay (Article 87)

(1) Amend introduction to read: "The City and M.E.A. agree to the following provisions effective July 1, 2000:"

(2) Amend section I as follows: "Employees in the classifications listed in Table 1 of this Article..."

(3) Designate list presently included at the end of Article 87, entitled "Classes Eligible for Certification Pay," as Table 1.

(4) Add a new section XI as follows:

"Employees in the classifications listed in Table 2 of this Article who obtain and maintain CWEA Laboratory Analyst or AWWA Water Quality Analyst certifications at the indicated grade levels will receive additional compensation for the indicated Grade obtained at the indicated additional compensation levels. Employees in these classifications would also receive 2.5% additional compensation for CWEA or AWWA voluntary certification in any other water or wastewater related discipline at any Grade. Additional compensation shall be cumulative with a maximum of 7.5% additional compensation for any employee in these classifications based on Table 2.

(5) Add Table 2 as follows:

<i>Job Classifications</i>	<i>Lab Cert. Grade</i>	<i>Add'l \$\$\$</i>	<i>Lab Cert. Grade</i>	<i>Add'l \$\$\$</i>	<i>O t h e r Cert.</i>
Ass't Lab Tech	I	2.5%	II	5.0%	2.5%
Lab Tech	I	2.5%	II	5.0%	2.5%
Biologist I	II	2.5%	III	5.0%	2.5%
Biologist II	II	2.5%	III	5.0%	2.5%
Biologist III	III	2.5%	IV	5.0%	2.5%
Sr. Biologist	IV	5.0%			2.5%
Junior Chemist	II	2.5%	III	5.0%	2.5%
Ass't Chemist	II	2.5%	III	5.0%	2.5%
Assoc. Chemist	III	2.5%	IV	5.0%	2.5%
Senior Chemist	IV	5.0%			2.5%
Marine Biologist I	II	2.5%	III	5.0%	2.5%
Marine Biologist II	II	2.5%	III	5.0%	2.5%
Marine Biologist III	III	2.5%	IV	5.0%	2.5%
Sr. Marine Biologist	IV	5.0%			2.5%

(6) Add a new section XII as follows: **Detailed Proposal Pending**

[Note: Pursuant to Article 21, subsection 9 of the MOU, MEA formed a Committee of volunteers in May 1999 which has developed criteria, solicited input, and invited proposals for Voluntary Certification Pay from interested employees. This Committee has evaluated a total of 14 proposals, which will now be heard and reviewed by the Negotiating

Team on April 28, 2000, as the final internal step in a very careful scrutiny of these proposals. MEA will thereafter present its position regarding which Voluntary Certification Pays it proposes should be added to Article 87 of the MOU for implementation effective July 1, 2000.]

F. "Pay For Performance Plan" (Article 88)

[MEA will submit "clean up" language related to this Article.]

G. Out-Of-Class Assignments (Article 60)

The 31-day "grace period" of no OCA pay should be eliminated. The imposition of this "grace period" occurred during the City's period of budgetary crisis and mandatory furloughs. There is no remaining economic justification for depriving employees of fair and equal compensation for services provided. The "grace period" concept has become a "disgrace" and undermines morale. When an employee is performing the duties of a job classification paid at a higher rate than his or her own regular classification, he or she should be compensated at this higher rate from day one.

H. Call-Back/Court Pay (Article 65)

Add COMMUNITY SERVICE OFFICERS to Section B, Court Pay.

I. Standby Pay (New Article)

(1) MEA requests clarification regarding terms of improvement in "on call compensation" for police officers which POA handout describes as "doubled from four to eight days."

(2) MEA intends to submit a proposal for enhancement of the standby pay available to eligible employees in the Police Department as a matter of equity between local agencies.

J. Bilingual Pay (Article 19)

As a matter of equity, the bilingual pay available to all employees providing the

services identified in this Article shall be seventy (70¢) per hour (same as in Police Department), and both "Korean" and "Sign" language shall be added to this Article (same as in Police Department). *For MEA units, add Chinese.*

K. Work Schedules (Article 17)

- (1) Implement a 4/10 alternative work schedule in the Police Department for all clerical work units and for Police Investigative Aides. *(See ADD'L LIST TO BE SUBMITTED.)*
- (2) Implement a 4/10 alternative work schedule for lifeguards.

L. Uniform Allowances

- (1) A "re-opener" on all uniform allowances shall be available on or about April 1, 2001, to address necessary adjustments/increases for FY 2002.
- (2) Effective July 1, 2000, the uniform allowance for Community Service Officers shall be increased from \$600 to \$700 (same as POII).
- (3) Effective July 1, 2000, the uniform allowance for Police Code Compliance Officers and Police Code Compliance Supervisors shall be increased from \$348 to \$700 (same as POII).
- (4) Marine Safety Lieutenants shall receive the additional allowance available to BSU-assigned lifeguards as they are required to comply with BSU uniform requirements.
- (5) Delete reference to "Field Representative" in the Police Department as there are none, and delete reference to the "Code Compliance Officer" series in the Police Department as they are all now designated as "Police Code Compliance."

M. Maternity Leave (New Article)

[MEA has initiated discussions with City Management and the City Attorney's office in an effort to identify one or more legally permissible approaches for increasing the amount of paid leave available to an employee on a maternity leave of absence in view of (1) the 30-day waiting period under the Long-Term Disability Plan, (2) the unavailability of any separate "sick leave" benefit for most employees, and (3) the availability of only a limited number of "annual leave" days for male and female employees alike, despite the predictably necessary absence associated with childbirth for female employees.]

N. Time Off For Blood Donation (Article 64)

(1) The release time available when an employee is a "super-donor" shall be enlarged from a maximum of two (2) hours to a maximum of four (4) hours.

(2) The maximum permissible hours of release time may be enlarged upon a showing that an otherwise eligible employee's medical condition warranted additional recovery time; in any event not to exceed four (4) hours for a regular donor and six (6) hours for a "super-donor."

III. NON-ECONOMIC PROPOSALS

A. Employee Representation (Article 8)

(1) Modify Section A, subsection 2 as follows:

During the required discussion of any document, including, but not limited to, an "Unsatisfactory" or "Below Standard" Performance Evaluation, written warnings, reprimands, note of counseling, or advance notice of failure of probation, which are to be made part of the employee's permanent record and/or which may be used as a basis for subsequent discipline.

B. Appeals (Article 37)

(1) Modify Section A as follows:

The employee may appeal the placement of any document, including but not limited to, an "Unsatisfactory" or "Below Standard" Performance Evaluation, or an Advance Notice of Probationary Failure, which is to be made a part of the employee's permanent record and which may be used as a basis for subsequent discipline, in his/her permanent record by submitting an appeal letter to the Department Head within ten (10) working days of the employee receiving any such document that is to be placed in his or her file.

IV. PROPOSALS AFFECTING MEA'S INTERESTS AS AN ORGANIZATION

A. Agency Fee Agreement (New Article)

MEA remains firmly committed to the implementation of an agency fee agreement whereby every employee in the bargaining units represented by MEA is required to pay his/her fair share of the costs associated with this crucial representational role and collective bargaining process.

B. Parkade Parking Pass Discounts For MEA Staff (New Article)

As a matter of equity between MEA and other City-employee labor organizations, parking passes for the City's "Parkade" parking structure shall be available for MEA's purchase at a discount for use by its staff.

EXHIBIT 10

CITY OF SAN DIEGO
M E M O R A N D U M

DATE: January 9, 2003

TO: Fred Pierce, President, San Diego City Employees' Retirement System

FROM: Ed Ryan, City Auditor and Comptroller

SUBJECT: Recommendations for Change in Administration of DROP Program

As you know, the City authorized the San Diego City Employees' Retirement System Board (Board) to administer a DROP program almost 6 years ago. This program is in the nature of a defined contribution program in contrast to a defined benefit program. The Board has set an 8% interest rate to be paid on funds deposited in the Reserve for Member's DROP Contributions which includes funds from members who are currently in the DROP program, as well as funds from retirees who are no longer in DROP. The latter group has been allowed to leave their money on deposit with SDCERS and earn 8% after they have terminated from the DROP program.

The passage of time and experience of the Board suggests that changes in the administration of the program are needed. I request that you bring for action, the following recommendations to the Board in February, 2003:

Recommendation 1

Contract out the DROP program with a third party administrator in the manner in which the City does with its other defined contribution programs of SPSP, 401 (k) and Deferred Compensation. Implicit in this recommendation would be that the investment market would drive the rate of return on these monies, not a rate set by the Board.

I make this recommendation, with no disrespect to Retirement staff, but rather to help them. These contracted programs allow for better service. They can provide daily status of funds, tailored investing, faster withdrawals and returns would be set at market rates. It would free up staff to focus on the basic defined benefit program which has become very complicated.

If Recommendation 1 is not adopted by the Board, then I recommend the following:

Recommendation 2

Immediately change the 8% interest rate paid to DROP accounts for retirees who are no longer in DROP but who have left their funds on deposit with SDCERS. I believe market rates should be paid in good or bad years.

It is my understanding that the Retirement Fund, and thus indirectly the City, is under no legal obligation to pay 8% earnings in today's market to retirees, no longer in DROP, who choose to invest their DROP funds with CERS. (See attached opinion of the Board's fiduciary Counsel). As of October 31, 2002, the CERS Trust Fund had net investment losses of over \$50 million and the actuary advised the Fund incurred an actuarial loss of \$313 million for the Fiscal Year ending June 30, 2002.

Currently about 250 members who are no longer in DROP have left \$38.8 million in DROP funds on deposit with CERS to earn 8%. At an 8% interest rate the fund is paying out over \$3.1 million annually. The amount on deposit is increasing this fiscal year by an average of \$2 million a month.

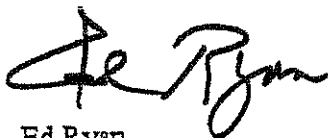
The increasing balances below illustrate how fast this expense is growing.

<u>Date</u>	<u>Amounts Left On Deposit by Retirees no longer in DROP</u>	<u>Annualized 8% Interest</u>
June 30, 2000	\$ 3,800,000	\$ 304,000
June 30, 2001	\$ 8,100,000	\$ 648,000
June 30, 2002	\$ 31,000,000	\$2,480,000
Nov. 30, 2002	\$ 38,800,000	\$3,104,000

Recommendation 3

Review the practice of crediting DROP accounts 8% for members currently in DROP. At the present time approximately 614 members currently in DROP have funds on deposit totaling over \$72 million. While members are in DROP, the DROP program should be administered as the defined contribution program that it is, rather than a "guaranteed" defined benefit program that it is not.

I am available to discuss this important issue at your earliest convenience.



Ed Ryan
City Auditor and Comptroller

ER/TAW/mp

cc: Lawrence Grissom, Retirement Administrator, MS-840
Michael Uberuaga, City Manager, MS-9A
SDCERS Board Members

EXHIBIT 11

ORDINANCE NUMBER O- **19071** (NEW SERIES)

ADOPTED ON JUN 18 2002

AN ORDINANCE AMENDING CHAPTER 2, ARTICLE 4, OF
THE SAN DIEGO MUNICIPAL CODE BY AMENDING
DIVISION 14 BY AMENDING SECTIONS 24.1401, 24.1402,
24.1403, 24.1404, 24.1405, 24.1406, 24.1407, 24.1408, AND
24.1409, ALL RELATING TO THE SAN DIEGO CITY
EMPLOYEES' RETIREMENT SYSTEM

WHEREAS, the City Council has the sole authority to establish the retirement benefits
available under the System; and

WHEREAS, the Board of Administration ("Retirement Board") for the San Diego City
Employees' Retirement System ("System") has the sole authority to administer the System,
determine the rights to benefits under the System and invest the System's Trust Fund; and

WHEREAS, the Retirement Board, as the administrator of the System and its benefits, is
uniquely situated to recognize and evaluate needed modifications or clarifications of existing
benefits under the System, as set forth in the San Diego Municipal Code ("Municipal Code");
and

WHEREAS, the Retirement Board recommends that the Deferred Retirement Option
Plan (DROP) be amended to allow DROP participants greater flexibility in how they receive
their DROP monies when they retire; and

WHEREAS, the Retirement Board recommends that, in order to offer the greatest
flexibility to DROP participants, the DROP provisions be amended to allow a DROP participant,

at the end of his DROP participation period, to elect to receive the monies in his DROP account in any of the following forms: (1) in lump sum, (2) by making periodic withdrawals in amounts and at times that are not predetermined, or (3) as an annuity in equal amounts for the period of the individual's life expectancy; and

WHEREAS, the DROP provisions must be amended to be consistent with historical practice and the expectations of the parties who participated in creating DROP; and

WHEREAS, to this end, the DROP provisions must be amended to clarify that a member entering DROP must irrevocably select his retirement option and name his beneficiary for any survivor benefit before entering DROP; and

WHEREAS, the DROP provisions must also be amended to clarify that the amounts credited to the member's DROP account that are equal to his retirement benefit are determined based upon the member's selection of a retirement option and election of a beneficiary; and

WHEREAS, the DROP provisions must also be amended to clarify that the member's benefit level is frozen when the member enters DROP, based upon the member's Final Compensation, age, service and retirement option selection at the time of entering DROP; and

WHEREAS, the DROP provisions must also be amended to clarify that UPD members may participate in DROP and that their DROP benefits are the same as the DROP benefits for City participants, except that they are paid for by the UPD; and

WHEREAS, the DROP provisions must also be amended to clarify that UPD participants leaving DROP are not Health Eligible Retirees, and are not entitled to City-paid health insurance; and

WHEREAS, the Retirement Board's Assistant General Counsel prepared this ordinance to make these recommended amendments to the DROP plan; and

WHEREAS, these proposed amendments will have no fiscal impact and will not affect any benefits that present Members are entitled to; and

WHEREAS, it is now necessary and appropriate to amend the Municipal Code to provide for the above-recited changes; and

WHEREAS, the sections of the Municipal Code reflecting the above-recited changes have been reviewed and approved by the Retirement Board; and

WHEREAS, the Retirement Board's Assistant General Counsel provided this ordinance to the City Attorney to review and finalize; and

WHEREAS, the Retirement Board now recommends that the City Council approve the amendments contained in this Ordinance; NOW,

BE IT ORDAINED, by the Council of The City of San Diego, as follows:

Section 1. That Chapter 2, Article 4, Division 14 of the San Diego Municipal Code is hereby amended to read as follows:

**Article 4: City Employees' Retirement System
Division 14: Deferred Retirement Option Plan**

§24.1401 Purpose and Duration

- (a) Effective April 1, 1997, a deferred retirement option plan (DROP) is created and offered to Members as an alternative method of benefit accrual in the Retirement System as set forth in this Division.
- (b) DROP is created to add flexibility to the Retirement System and its Members. It provides Members who elect to participate in DROP access to a lump sum benefit.

at the time of their actual retirement, in addition to their normal monthly retirement allowance. DROP is intended to be cost neutral.

- (c) DROP was initially offered on a trial basis for a period of three years beginning on April 1, 1997. DROP became a permanent benefit effective April 1, 2000.

§24.1402 Eligibility, Duration of DROP Participation, Selection of Survivor Option and Waiver

- (a) Any Member who is eligible for a service retirement is eligible to participate in DROP, except for a Safety Member who elects to accrue benefits under Section 24.0403(g).
- (b) Before a Member may participate in DROP, he or she must voluntarily and irrevocably:
 - (1) designate a participation period of 60 consecutive months or less;
 - (2) elect to receive either the Maximum Benefit or one of the retirement settlement options described in Division 6 of this Article;
 - (3) designate his or her Beneficiary for the continuance payable upon his or her death, if any;
 - (4) stop accruing benefits under any other Division of this Article starting on the date the Member enters DROP;
 - (5) have DROP benefits credited to a DROP Participation Account as provided in this Division;
 - (6) accrue benefits under the terms of this Division starting on the date the Member enters DROP;

- (7) receive benefits from the Retirement System when the Member leaves City or Port District employment, as provided in the relevant sections of this Article;
- (8) agree to leave City or Port District employment on or before the end of the Member's designated DROP participation period; and
- (9) waive his or her right to assert a claim or bring an action against the City, the Port District or the Retirement System based upon age discrimination or any other employment discrimination law arising out of the Member's participation in DROP or the requirement that he or she leave employment at the end of his or her DROP period.

§24.1403 Termination of DROP Participation

- (a) A Member who is participating in DROP may leave DROP at any time before the end of his or her designated DROP participation period by voluntarily leaving City or Port District employment.
- (b) The Retirement System will terminate the Member's participation in DROP when any of the following events occurs:
 - (1) the Member's designated DROP participation period ends;
 - (2) the Member's City or Port District employment is terminated for cause; but, if the termination for cause is reversed, the Member's participation will be reinstated for the remainder of the Member's designated DROP participation period, less any benefits previously distributed from the Member's DROP account;

- (3) the Member dies; or
- (4) the Retirement Board grants the Member a disability retirement.

§24.1404 DROP Benefits and Participation Accounts

- (a) A DROP Participation Account is a “nominal” account established within the Retirement System on behalf of each DROP participant. All benefits accrued by a Member under this Division are accounted for in the Member’s DROP Participation Account. A DROP participant does not have a claim on the assets of the Retirement System with respect to his or her DROP Participation Account, nor will the System set aside any assets for any DROP participant that are separate from other System assets.
- (b) All amounts credited to a Member’s DROP Participation Account are fully vested.
- (c) A Member’s DROP Participation Account will be credited with:
 - (1) An amount, credited monthly, which is calculated in the same manner as an Unmodified Service Retirement Allowance using the Member’s age, Creditable Service, Final Compensation and selected retirement option, in effect on the date the Member enters DROP, as well as the retirement benefit levels in place on that date. This amount will increase each year by a cost of living adjustment (COLA), as described in Division 15 of this Article.

- (2) An amount, credited annually, representing the annual supplemental benefit described in Division 15 of this Article, based upon the Member's Creditable Service on the day before the Member entered DROP.
- (3) An amount equal to 3.05% of the Member's Base Compensation, credited bi-weekly at the end of each pay period, which is paid by the City or the Port District.
- (4) An amount equal to 3.05% of the Member's Base Compensation, credited bi-weekly at the end of each pay period. This amount will be deducted from the Member's salary on a pre-tax basis pursuant to Internal Revenue Code section 414(h)(2).
- (5) Interest on the above amounts, as determined by the Board through rules and regulations adopted under Division 9 of this Article. These rules and regulations will have the same force and effect as a duly adopted ordinance.

§24.1405 Additional DROP Provisions

- (a) The Member and the City or Port District will stop making employer and employee contributions for the Member on the day the Member enters DROP.
- (b) A Member who becomes disabled while participating in DROP is eligible to apply for disability retirement benefits. If the Member's application for disability retirement benefits is approved by the Board:

- (1) the Member's disability retirement benefit will be calculated using the Member's age, Creditable Service, and Final Compensation in effect the day the Member entered DROP; and
 - (2) the Member will be eligible to receive all amounts in his or her DROP Participation Account, as provided in Section 24.1407.
- (c) If a Member dies while participating in DROP, his or her Beneficiary or Beneficiaries will receive:
- (1) All amounts in the Member's DROP Participation Account.
 - (2) The retiree death benefit.
 - (3) If the Beneficiary is eligible to receive an industrial death benefit, the Beneficiary may elect to receive this benefit in place of any survivor continuance otherwise payable under this Division. The benefit will be calculated using the Member's age, Creditable Service and Final Compensation in effect on the day the Member entered DROP.
 - (4) If the Member's Beneficiary is ineligible for an industrial death benefit, and the Member designated a Beneficiary to receive a continuance before entering DROP, the Member's Beneficiary will receive the survivor continuance elected by the Member.
- (d) A City employee Member who elects to participate in DROP will qualify as a Health Eligible Retiree and be eligible to receive Post Retirement Health Benefits under Division 12 when the Member leaves DROP and retires.

- (e) No beneficiary designation made under this Section may abrogate the Member's community property obligations under applicable California law.

§24.1406 Designation of Beneficiary

- (a) Before entering DROP, the Member must designate a Beneficiary for his or her DROP Participation Account. This designation will apply to all distributions made from the Member's DROP Participation Account. The Member may change this Beneficiary designation at any time before the amounts in his or her DROP Participation Account are fully distributed.
- (b) If the Member's DROP Participation Account Beneficiary dies before the Member does, and the Member then dies before designating a new Beneficiary, all amounts in the Member's DROP Participation Account will be distributed to the Member's estate.
- (c) No Beneficiary designation made under this Section may abrogate the Member's community property obligations under applicable California law.

§24.1407 Payment of Benefits

- (a) When a Member simultaneously leaves DROP and leaves City or Port District employment:
 - (1) the Member will begin receiving his or her monthly retirement allowance, as determined under this Division; and
 - (2) the Member will begin receiving the annual supplemental benefit in accordance with Division 15, to the extent the Member is eligible, based

upon the Member's Creditable Service on the day he or she entered DROP.

- (3) the Member will be entitled to receive the amounts credited to his or her DROP Participation Account as of the day the Member left DROP.
- (b) A Member may receive the amounts in his or her DROP Participation Account in any of the following benefit forms:
- (1) a single lump sum distribution of all amounts credited to the Member's DROP Participation Account,
 - (2) equal monthly payments over 240 months starting with the date the Member leaves DROP and retires, or
 - (3) any other benefit form approved by the Board, subject to applicable provisions of the Internal Revenue Code.
- (c) The following rules govern the payment of benefits under this Division:
- (1) No COLA, Annual Supplemental Benefit or later similar adjustment will be made with respect to any benefit payable under subsection (b).
 - (2) Each form of benefit paid must be the Actuarial Equivalent of the amount credited to the Member's DROP Participation Account at the end of his or her DROP participation period. Where appropriate, the Annuity will be calculated using the Member's age and, if the Member elected a joint and survivor option, the age of the Beneficiary at the end of the DROP participation period.

- (3) Each form of benefit paid must equal the amount credited to the Member's DROP Participation Account, including interest credited to that account after the Member retires. If amounts remain credited to the Member's DROP Participation Account after the Member's death, the System will pay the remaining amounts to the Member's Beneficiary in the form selected by the Member before his or her death. If the Member did not select a form, the Beneficiary may elect to be paid under any of the benefit forms provided in subsection (b).
- (d) The Retirement System will credit the DROP Participation Accounts of retired Members as follows:
- (1) If a Member or Beneficiary receives a benefit in a form other than a single lump sum distribution of the entire DROP Participation Account, the value of his or her DROP Participation Account will be credited with interest quarterly and reduced by the amount of distributions.
- (2) The interest rate credited to the DROP Participation Account under subsection (d)(1) may not exceed the higher of the following:
- (A) 5% , or
- (B) the interest rate the Board is using to credit DROP Participation Accounts on the date the Member is first eligible to receive distributions from his or her DROP Participation Account.

§24.1408 Compliance with Applicable Provisions of the Internal Revenue Code

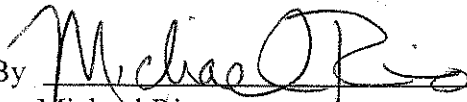
- (a) DROP is not intended to jeopardize the tax-qualified status of the Retirement System under the rules and regulations of the Internal Revenue Service. The Board has the authority under Division 9 of this Article to adopt rules and regulations to assure that DROP complies with applicable Federal laws and regulations. The Board's rules and regulations will have the same force and effect as a duly enacted ordinance.
- (b) Despite any other provision in this Article, benefits provided under this Division are subject to the requirements of the Internal Revenue Code and regulations issued thereunder for the Retirement System to remain a tax qualified retirement plan, including the following:
 - (1) The limitations of Section 415 of the Code relating to the amount of benefits that can be paid. In this regard, the interest rate that will be used for testing benefits under the limits of Section 415 and DROP benefits will be the greater of the following:
 - (A) 5%, or
 - (B) the interest rate the Board is using to credit DROP Participation Accounts on the date the Member is first eligible to receive distributions from his or her DROP Participation Account.
 - (2) The limitations of Section 401(a)(17) of the Code relating to the amount of compensation that can be taken into account for benefit accrual.

- (3) The limitations of Section 401(a)(9) relating to the time that benefit payments must begin.
- (4) The rules of Section 401(a)(31) relating to the rollover of benefits.
- (5) The limitations of Section 401(a)(25) relating to "definitely determinable" benefits.

§24.1409 Employment Status during DROP Participation

Except as provided in this Division, a Member who elects to participate in DROP has all of the rights, privileges and benefits, and is subject to all other terms and conditions of active employment, including the City Flexible Benefits Plan.

APPROVED: CASEY GWINN, City Attorney

By 
Michael Rivo
Deputy City Attorney

RSP:MR:sn:ms
05/21/02
05/30/02 Corrected Copy
Or.Dept: Retirement
O-2002-140
Form=o&t.frm

EXHIBIT 12

February 8, 2003

Councilmember Jim Madaffer
Seventh District
City Administration Building
202 C Street, MS 10A
San Diego, CA 92101

Dear Councilmember Madaffer:

First, I would like to thank you for supporting the payment of the 13th check to eligible City retirees last year. The check meant a lot to many retirees. I am hoping that you will again help us by protecting our contingent benefits.

On February 12, 2003, the Rules Committee will be reviewing a report from the San Diego City Employees' Retirement System that responds to questions from the Mayor's Blue Ribbon Committee on City Finances. The questions were related to the City's funding of its pension and health insurance obligations for retired City employees. Alternative methods for various levels of funding are provided in the report. When this matter comes you, please support an alternative that would provide permanent funding for the 13th check, Corbett settlement, and Supplemental COLA, and protect the retiree health benefit. Currently payment of these benefits is dependent on the Surplus Undistributed Earnings of the Trust Fund.

I realize that sometimes the best alternative is not possible. If payment of contingent retiree benefits must continue to rely on Surplus Undistributed Earnings, I ask that you consider the following:

Crediting of DROP Interest

Due to the hierarchy set forth in SDMC 24.1502 for distribution of Surplus Undistributed Earnings, interest is credited to all Member accounts prior to an amount sufficient to pay the Retiree Health Benefit, the 13th check, the Corbett settlement and the crediting of interest to the Supplemental COLA reserve. It has been assumed that all DROP participation accounts are Member accounts and as such must be credited annually with interest as determined by the Board. This interest rate has traditionally been the 8% assumed interest rate of the fund.

Monies do not have to be withdrawn from DROP accounts at the time of termination from City employment and can be left on account almost indefinitely. Monies left on account are drawing 8% interest during a down economy when passbook earnings are in the 2-3% range. Last year funds were transferred from the Employer Contribution Reserve to credit this interest because there were insufficient Surplus Undistributed Earnings. No Surplus Undistributed Earnings will be available this year. This could be an ongoing trend. (The Corbett settlement payments are not anticipated to be paid for three to four years because of market conditions.) It is a logical assumption that when the economy improves retiree participants will withdraw their DROP monies to fund more lucrative investments, as they did several years ago when investments were earning double-digit returns. If this occurs, the System will not be given the opportunity to make itself whole by capturing the higher earnings necessary to offset the high interest credited to accounts during the down market.

I argue that the elements of SDMC 24.1404 (DROP Benefits and Participation Accounts) relating to interest crediting apply to the DROP accounts of active employed Members only, not retired DROP participants. At the time a DROP participant terminates employment with the City, he or she is no longer a Member of the System. The participant becomes a retiree and at that moment has access to all monies in his or her DROP account. As a retiree, the participant can roll the lump sum amount of the DROP participation account into any qualified investment vehicle of choice without tax consequences.

Because of the high interest rate credited to DROP accounts, a greater percentage of retiree DROP participants are leaving monies on account with the System. This trend could eliminate any funds available to pay the 13th check and the Corbett settlement for many years to come and weaken the level of benefit provided under the Retiree Health Benefit. Every dollar credited to a DROP participant account is one less dollar available to pay contingent retiree benefits.

The June 30, 2002, Actuarial Valuation reflects 522 employees in DROP with an annual DROP retirement allowance of \$50,892. If a DROP participant remains in the program for 5 years earning 8% per year, the participant would have a lump sum of \$311,615 at the time of retirement. Additionally, the participant would receive an annual base pension of \$50,892 plus adjustments for inflation. If the participant left the monies on account earning 8% for an additional 5 years after terminating employment, he or she would have a lump sum of \$464,258. Of that amount \$35,580 would be the interest accrued during the last year. This interest is more than twice the average annual retirement allowance of a General Member retiree.

The Actuarial Valuation further reflects that 25% of all Safety members are eligible to enter DROP within a 5 year period. 211 or 7.6% are eligible now, and 482 or 17.4% by the end of the 5 year period. The average salary of these Safety members is \$71,290. Additionally, 15.7% of all General Members are eligible to enter DROP within a 5 year period: 328 or 4.3% now, and 872 or 11.4% by the end of the 5 year period. The average salary of these General Members is \$55,818.67. (The underlying calculations for these figures can be provided for your reference.)

Approximately 18.2% of all active member are eligible to enter DROP within the next 5 years. Even if 75% to 80% of those who are eligible enter DROP, the amount of interest credited to the DROP accounts will be huge. SDMC 12.1401(b) states that when DROP was created the program was intended to be cost neutral. Is this still the case?

The August 2002 pension payroll reflected that of 5,343 retirees, 334 received less than \$350 per month, 804 received between \$350 and \$499, and 1,094 received between \$500 and \$999. The average annual General Member retirement allowance as of June 30, 2002, was \$16,400. These are just some of the retired employees who are at risk of losing their contingent retiree benefits because of the escalating amounts necessary to credit DROP participant accounts.

I respectfully request that Council find a permanent funding source for our contingent retiree benefits. If this is not possible, please consider changing the rate of interest credited to retiree DROP accounts left on account with the System to be either a) the actual rate of return on System assets not to exceed the assumed interest rate of the fund, or b) some type of rate tied to the average interest on long term certificates of deposit. I offer this request even though it will affect our family personally. My husband is a retiree DROP participant who has money on account with the System. However, we feel it is not equitable if benefits that are life-sustaining to retirees earning an average of \$16,400 annually are left unfunded because of interest paid on the accounts of active Member/retiree DROP participants. Please remember and support older, loyal retired employees of the City of San Diego.

Retiree Health Benefit

The retiree health benefit is one of the most important benefits that retirees receive. It was originally created in 1982 when the City withdrew from Social Security. R-255320, adopted November 2, 1981, stated "the City of San Diego has given notice to the State of California of its intention to withdraw from the Social Security System" and "it is further intended as an in-lieu benefit to amend the Retirement System for future retirees to provide medical insurance on the same basis as is provided to City employees." O-15758 (New Series), adopted on June 1, 1982, states that "certain benefits shall be provided to employees in lieu of Social Security participation and "it was the intent to provide such coverage as a permanent benefit for eligible retirees." The City has not reentered the Social Security System. The benefit is still permanent.

I have copies of these and subsequent documents that define City-paid health insurance as a permanent benefit. I am happy to provide you copies of these documents if you wish to review them.

Without the Retiree Health Benefit many members would not be enrolled in a health plan due to the high cost of insurance. It is anticipated that we will not receive the 13th check and Corbett settlement for several years due to economic conditions. Please protect the retiree health benefit by funding it as fully as possible.

Conversion of Annual Leave to Creditable Service in the Retirement System

O-19126 (O-2003-74) amends the SDMC to reflect the recently negotiated benefits for Local 145. The ordinance states that the conversion of Annual Leave to Creditable Service in the Retirement System, or the use of Annual Leave to extend the Member's DROP participation period, may result in an increase to the Retirement System's unfunded liability and a corresponding increase to the City's contribution rate over and above the scheduled rates in the Manager's Proposal II. On page 4 of the Ordinance, it states that *"these increases may occur because the City will not be transferring to the Retirement System the cash equivalent of the Annual Leave underlying the conversion to Creditable Service or the extension of the period of DROP participation in these Annual Leave conversion transactions."*

This is an item of great concern as it relates to the lowering the funded ratio of the Trust. If no money will be deposited into the System for the purchase of creditable service using Annual Leave conversion, how is the System made whole? Creditable service purchased in this manner does not appear to meet the requirements of Charter Section 141 which clearly defines service as time "for which payment has been made." It is interesting to note that if service purchased in this manner is used for eligibility to enter DROP, the Member's DROP account will be credited with 8% interest on that portion of the retirement allowance generated by Annual Leave conversion for which the System has received no money. Additionally, with the newly negotiated removal of the prohibition to use the five-year purchase of service credit toward the 10 years necessary to vest, Fire Safety Members can also use annual leave conversion (for which no money was placed in the System) to purchase a service or non-industrial retirement benefit. Do any other public retirement systems use this method of financing a benefit?

Thank you for taking the time to read my letter. If you have any questions regarding the issues reflected above, please contact me at (858) 270-3364.

Sincerely,

Judith Folsom
4551 Ariane Way
San Diego, CA 92117

EXHIBIT 13

CITY OF SAN DIEGO
MEMORANDUM


Gave pencil
comments
to Cathy
12-30-03
3:30

Date: December 30, 2003
To: Honorable Mayor and Council
From: Michael T. Uberuaga, City Manager
Subject: Facts Related to the City's Retirement Benefits/Deferred Retirement Option Plan

Attached is a brief summary of the City's Retirement benefits, particularly the Deferred Retirement Option Plan (DROP) for your information. We have provided some examples of how DROP works, and how DROP has saved costs to the City.

Also attached is information related to the retirement benefits of other public jurisdictions in the County and in the State.

If you have any questions about this information, please contact Cathy Lexin, Human Resources Director, at 236-5951 or cell phone 980-4208.

for 
Michael T. Uberuaga

MTL/CL

Attachments

City of San Diego Employees Retirement System/Benefits

12/30/03

I. Type of Plan: San Diego has a defined benefit retirement plan which requires 10 years of service to receive a benefit. The benefit is based upon a formula that multiplies (Years of Service) x (a set %) x (highest one year salary) See below:

II. Benefits:

General Members

10 years at age 62 or
20 years at age 55

x 2.5% x Salary = Benefit

Safety Members

10 years at age 55 or
20 years at age 50

x 3.0% x Salary = Benefit

III. Funding: The System is funded by contributions from the City, contributions from employees, and from earnings on the investment of these contributions.

IV. Average Benefit of all Retirees (5,467#)* Average Benefit FY03 Retirees (470#)*

General Members \$19,613 (3,223) \$43,399 (332)
Safety Members \$36,410 (2,244) \$62,011 (138)

Total Members \$26,508 (5,467) \$48,864 (470)

* Based upon 6/30/03 preliminary Actuarial Valuation.

V. Comparison to other Comparable Public Jurisdictions: The City of San Diego's retirement formulae are typical of other comparable public jurisdictions. *Attached* are charts comparing the City of San Diego with San Diego County, the Port of San Diego, the other Cities within San Diego County and the 10 largest cities in California.

Deferred Retirement Option Plan (DROP)

VI. Origin: On March 4, 1997, (O-18385) the City Council unanimously adopted the DROP plan to become effective April 1, 1997, as a three year trial program. Up until April 1, 2000, City could have determined not to continue DROP, after meeting and conferring, if it was determined not to be cost effective for the City. After reviewing data prepared by the SDCERS actuary in the spring of 2000, the City concluded that DROP had a cost neutral impact to the City. DROP became a permanent feature of SDCERS benefits effective April 1, 2000.

The Port of San Diego, through its agreement with SDCERS, chose to offer DROP to its employees in 1997 as well, under the same terms as City employees. Staff is aware of at least eleven other public jurisdictions who offer DROP plans.

- VII. What is DROP: DROP is an alternative by which employees can elect to accrue their already-earned service retirement benefit. Once an employee becomes eligible for a service retirement (see above), an employee may enter DROP. Upon entering DROP, the employee is treated as if retired; their benefit is set and frozen (e.g. age 55 with 20 years of service at 2.5%/year, and a salary of \$50,000 = \$25,000/year).

During DROP, the City ceases to make contributions since the employee's benefit is frozen and the employee is considered retired by CERS. Instead, the City and the employee each contribute 3.05% of salary into the DROP account. In FY04, the City's pays 3.05% for DROP members rather than 13.43%. In addition, City stops making the "pickup" of employee contributions, saving between 7% and 10% (general member or safety). The total savings to the City in FY04 from not making these payments is estimated to be \$8.3 million. In FY05, the total savings to the City is estimated to be \$9.4 million. These DROP accounts are only nominal accounts, held by CERS and invested along with all CERS assets until such time as the employee actually retires and elects to take a distribution, subject to applicable tax rules. DROP accounts accrue interest established by CERS.

- VIII. Comparison of Benefits with and without DROP: Prior to implementing the DROP plan, this same employee (described in VII above) was already entitled to retire at 55 and receive this \$25,000/year benefit. Prior to DROP, this employee could have increased his/her benefit by adding 5 years of service and counting salary increases toward the formula. (E.g. 25 years x 2.5% x \$56,275 using +3%/year = \$37,172/year). Under either scenario, with or without DROP plan, the City would be paying the salary (either to this employee or a replacement employee).

EXAMPLES (using FY04 Contributions Rates):

Employee's Benefit

City's Cost

1. General Member X with 20 years
Retires at age 55 earning \$48,077*/year

A replacement employee is hired at \$48,077 salary
Plus City pays 13.43% of salary toward retirement = \$6,457 + any increases based on salary or rate
Plus City "picks up" first 7% of employee's contribution = \$3,365

Receives Retirement Benefit of \$24,038

Salary & Retirement = \$57,899

2. Same General Member X with 20 years
DROPS at age 55 earning \$48,077/year.
\$24,038/year accrues for up to 5 years
Because employee by IRS rule cannot take receipt of DROP funds, CERS adds 8% interest
Five years later, employee *actually* retires.

Same employee continues to earn \$48,077/year
City pays 3.05% of salary to DROP account = \$1,466/year

Salary and DROP = \$49,543

DROP funds accrued become available and employee continues with same level of benefit with no additional credit for last five years of service, nor for higher salary calculation.

3. Same General Member X with 20 years
opts to work another 5 years and not DROP
Retires at age 60 with 25 year of service
- Assume 3% salary increase per year = \$54,111

City pays \$48,077 plus any increases
City contributes 13.43% of salary
to CERS or \$6,457/year + any
increases based on salary or rate
Plus City "picks up" first 7% of
employee contribution = \$3,365

Receives Retirement Benefit of \$33,819

Salary and Retirement = \$57,899

* \$48,077 = current average salary of a general member per 6/30/03 preliminary actuarial valuation

IX. Numbers of Employees Participating in DROP (as of 6/30/03 preliminary actuarial valuation):

		<u>Average DROP Allowance</u>	<u>Total for Category</u>
General Members	347	\$42,679	\$14,809,595
Lifeguards	2	\$52,783	\$ 105,565
Police	209	\$62,180	\$12,995,578
Fire	174	\$66,340	\$11,543,187
Total	732	\$53,899	\$39,453,925**

** Because these employees have frozen their benefit, the City did not pay the 13.43% CERS contribution, but only 3.05% per the DROP plan, resulting in a savings to the budget in FY03 of approximately \$5.5 million. The City also saves from the annual budget, its "pick up" of employee contributions ranging from 7% to 10% of salary.

- X. Retirement Benefits Vest at time of hire/enrollment in CERS: Generally, retirement benefits are vested and protected by the contract clause of the Constitution (Kern v. City of Long Beach 29 Cal.2d 848, 852-853 (1947) at the time the employee is hired and entered into the System. DROP is a feature the City's defined benefit plan. The City Council could chose to close the current CERS plan entirely, modify it for new hires, modify or eliminate DROP feature only for new hires; all subject to meet and confer requirements..

City vs. County Comparison General Member Retirement Formulas

Age	City %	County %
55	2.50	2.50
56	2.50	2.60
57	2.50	2.70
58	2.50	2.80
59	2.50	2.90
60	2.55	3.00
61	2.60	3.00
62	2.65	3.00
63	2.70	3.00
64	2.75	3.00
65+	2.80	3.00

City of San Diego

LOCAL AGENCY

GENERAL

SAFETY

Carlsbad

2% @ 50

2% @ 55

Chula Vista

3% @ 50

3% @ 60

Coronado

2% @ 50

2% @ 60

County of SD

3% @ 50

2.5% @ 55

El Cajon

3% @ 50

2% @ 55

Encinitas

3% @ 50

2% @ 55

Escondido

3% @ 50

2% @ 55

La Mesa

3% @ 50

2% @ 55

National City

3% @ 50

2% @ 55

Oceanside

3% @ 50

2% @ 55

Port of SD/Airport

3% @ 50

2.50% @ 55 (4/04)

3.0 @ 55 Management

Poway

3% @ 50

2% @ 55

San Marcos

2% @ 50

2% @ 55

San Diego

3% @ 50

2.5% @ 55

Santee

3% @ 50

2.5% @ 55

Vista

2% @ 50

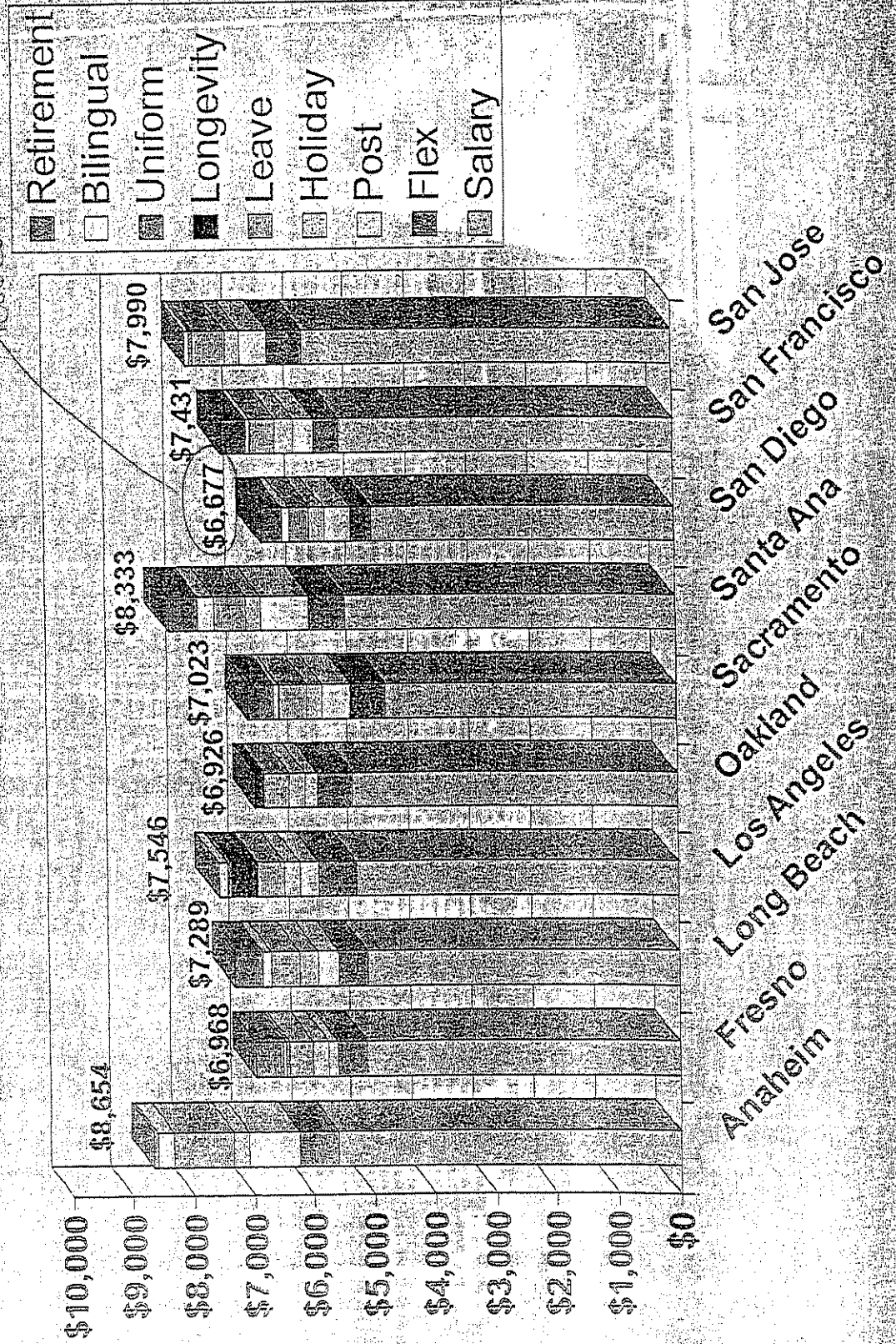
2% @ 55

Statewide Comparables

<u>AGENCY</u>	<u>SAFETY</u>	<u>GENERAL</u>
Anaheim	3% @ 50	2% @ 60
CHP	3% @ 50	2% @ 55
Fresno	2.75% @ 50	2% @ 55
Long Beach	3% @ 50	2.7% @ 55
Los Angeles	2.50% @ 50	2.16% @ 55
Oakland	3% @ 50	2% @ 55
San Diego	3% @ 50	2.5% @ 55
San Francisco	3% @ 55	2% @ 60
San Jose	3% @ 50	2.25% @ 55
Sacramento	3% @ 50	2.5% @ 55
Santa Ana	3% @ 50	2% @ 55
State of CA	3% @ 50	2% @ 55

Police Comparison

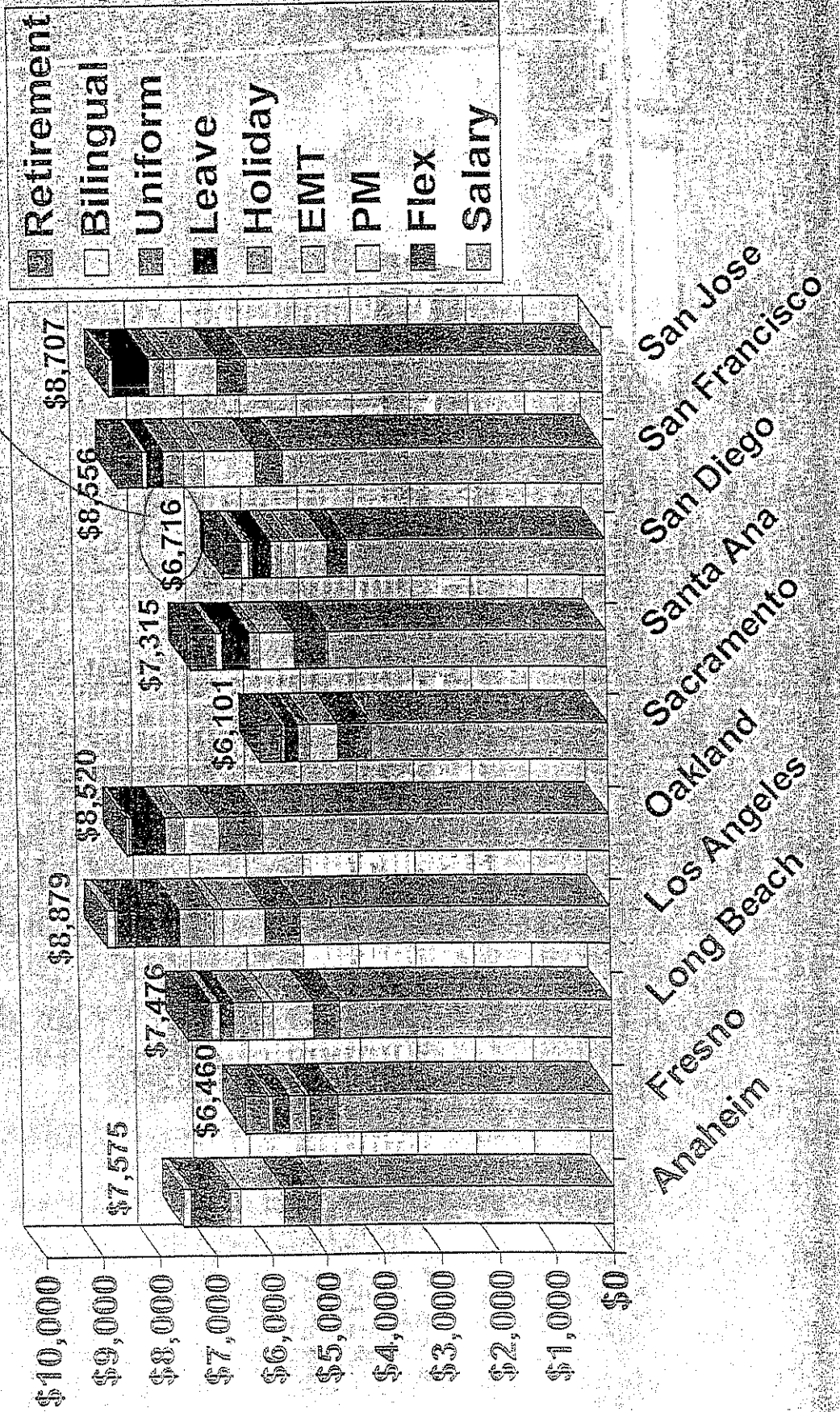
Total Compensation - Monthly



Fire Comparison

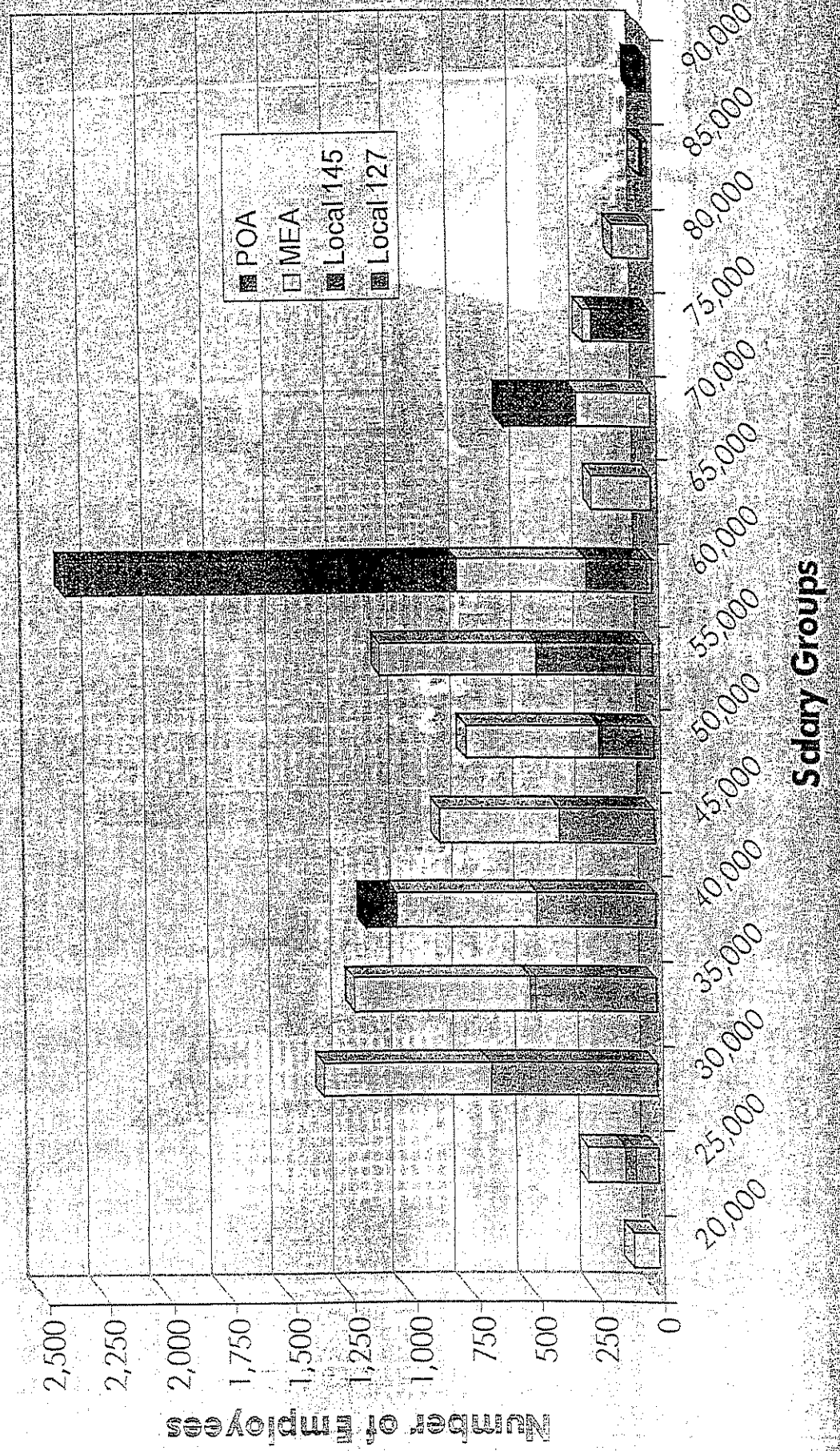
Total Compensation - Monthly

See lowest



Bargaining Unit Employee Counts by Salary Range

(salary rounded to nearest \$5,000)



SDCERS

10 Year History of Returns

Fiscal Year End (June 30)	City of San Diego Financial Statements (Actuals)*		SDCERS' Total Annual Return	Estimated Total G/L ***
	Book Value	Market Value**		
1992	993,131,528	1,089,368,615	10.47%	114,056,894
1993	1,087,547,749	1,200,099,221	1.35%	16,201,339
1994	1,173,108,353	1,207,280,665	15.11%	182,420,108
1995	1,282,484,769	1,387,070,018	15.08%	209,170,159
1996	1,431,099,641	1,589,408,514	16.88%	268,292,157
1997	1,555,986,514	1,840,503,639	14.62%	269,081,632
1998	1,790,764,252	2,115,573,556	9.53%	201,614,160
1999	2,096,436,647	2,293,432,604	14.93%	342,409,488
2000	2,669,002,272	2,627,941,645	-0.45%	(11,825,737)
2001	2,672,101,090	2,579,920,772	-2.48%	(63,982,035)
2002	2,557,295,603	2,504,295,267		
Cumulative Totals		1,668,572,618		1,527,438,165

Annualized 10 Year Rate of Return (as of June 30, 2002): 9.28%

Actuarial Assumption Rate: 8.00%

Note: Beginning market values not adjusted for cash flows of employer / employee contributions or benefit / expense payments
 * Source: City of San Diego Auditor's Office SDCERS' June 30 financials and SDCERS 5th Page portfolio accounting statements
 ** Market Value is defined as all invested assets at State Street Bank, net of pending sales and purchases of securities at June 30
 *** Estimated Gain / Loss is calculated using Total Return earned during a fiscal year multiplied by the prior FY market value (beginning value)

File Name: w:\invest\Annual Financial Report\Dollar Return Performance History-2.xls

San Diego County Employees' Retirement Association
Funding Progress Indicators - Historic Comparison

(\$ in Thousands)

Continuation Indicators

Valuation Date	Valuation Assets	Actuarial Accrued Liability	Funded Ratio	Unfunded Actuarial Accrued Liability	Member Payroll	Ratio to Payroll
12/31/86	\$ 619,951	\$1,073,488	57.8%	\$453,537	\$297,152	152.6%
12/31/87 ¹	734,851	1,088,159	67.5	353,308	340,499	103.8
12/31/88	812,527	1,175,599	69.1	363,072	365,651	99.3
6/30/89	853,852	1,327,127	64.3	473,276	391,329	120.9
6/30/90	941,482	1,447,574	65.0	506,092	444,841	113.8
6/30/91 ^{2,3,4}	1,124,418	1,588,594	70.8	464,176	494,285	93.9
6/30/92	1,274,729	1,748,589	72.9	473,860	525,411	90.2
6/30/93 ²	1,438,093	1,891,844	76.0	453,751	533,124	85.1
6/30/94 ⁵	1,947,310	2,006,689	97.0	59,379	535,981	11.1
6/30/95	2,086,777	2,148,606	97.1	61,829	550,737	11.2
6/30/95 ⁴	2,172,890	2,148,606	101.1	(24,284)	550,737	(4.4)
6/30/96	2,370,519	2,275,887	104.2	(94,531)	561,692	(16.8)
6/30/96 ^{1,2}	2,370,519	2,340,663	101.3	(29,856)	561,692	(5.3)
6/30/97	2,688,098	2,505,271	107.3	(182,827)	581,453	(31.4)
6/30/97 ^{1,2}	2,688,098	2,487,917	108.0	(200,181)	581,453	(34.4)
6/30/98	2,990,733	2,644,916	113.1	(345,817)	599,847	(57.7)
6/30/98 ⁶	2,834,571	2,677,593	105.9	(156,978)	599,847	(26.2)
6/30/99	3,211,872	2,990,111	107.4	(221,761)	642,780	(34.5)
6/30/00 ²	3,568,671	3,248,822	109.8	(319,849)	672,477	(47.6)
6/30/01	3,745,600	3,506,828	106.8	(238,772)	731,130	(32.7)
6/30/02	3,831,334	3,863,108	99.2	31,774	810,389	3.9
6/30/02 ⁷	3,831,334	5,078,067	75.4	1,246,732	810,389	153.9
10/03/02 ⁸	4,278,240	5,183,340	82.5	905,100	818,704	110.6

¹ After change in economic assumptions.

² After change in actuarial assumptions.

³ After including the Reserve for Future Deficiencies in the assets allocated for funding.

⁴ After change in asset valuation method.

⁵ After Pension Obligation Bond

⁶ Reflects supplemental benefit reserve transfer of 156.2 million and assumption increases totalling 32.7 million.

⁷ Reflects benefit increases, assumed earlier retirement, \$117.2 million supplemental benefit reserve transfer and change in amortization period to 10 years

⁸ Reflects \$550 Million Pension Obligation Bond, 15-year amortization and two Reserves newly excluded from assets

City
History of Funded Ratios
6/30/80 to 6/30/02

<u>Valuation Date</u>	<u>Funded Ratio</u>	<u>Valuation Date</u>	<u>Funded Ratio</u>
6/30/80	72.7%	6/30/92	95.2%
6/30/81	72.9%	6/30/93	96.5%
6/30/82	75.6%	6/30/94	94.2%
6/30/83	78.7%	6/30/95	92.7%
6/30/84	81.8%	6/30/96	91.4%
6/30/85	86.6%	6/30/97	93.3%
6/30/86	90.1%	6/30/98	93.6%
6/30/87	95.8%	6/30/99	93.2%
6/30/88	95.8%	6/30/00	105.0%
6/30/89	94.8%	6/30/00*	97.3%
6/30/90	95.1%	6/30/01	89.9%
6/30/91	94.6%	6/30/02	77.3%

* Reflects Corbett non-contingent benefit increases

Source: San Diego City Employees' Retirement System Annual Actuarial Valuation

SDCERS Fund and Other Public Employee Retirement System Funds in California

Based on a recent survey conducted by SDCERS staff, of twenty-one comparable pension systems in California, all but one reported a decline in their funded ratio in Fiscal Year 2002. (Four systems did not report 2002 results, since their fiscal years ended on December 31, 2002). Funded ratios were also down in 2001, with sixteen systems reporting declining ratios; four reporting increases, and one not responding. Ten of the systems surveyed indicated that they had previously issued Pension Obligation Bonds (POBs) and five indicated they are considering issuing POBs in the future.

Almost all of the funds surveyed reported negative investment returns in 2001 and 2002, with 18 of 20 respondents reporting negative returns in 2001 and 15 of 16 respondents reporting negative returns in 2002. All of the systems reported using smoothing techniques in developing the actuarial value of system assets, with most using a 5-year smoothing period, which is the method used by SDCERS.¹

Approximately one-half (9 out of 21) of the survey respondents indicated that their system pays for retiree health benefits, with four indicating that they actuarially fund the requirement, and the remaining five indicating a pay-as-you-go approach.

¹ Asset smoothing is used to estimate the current year's market value of plan assets, by calculating the average percentage difference between book value and market value of plan assets over the preceding five year period and applying that factor to the current year's book value of plan assets.

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM

EXECUTIVE SUMMARY

June 30, 2003 Actuarial Valuation



December 18, 2003

Gabriel, Roeder, Smith & Company



GABRIEL, ROEDER, SMITH & COMPANY

Consultants & Actuaries

9171 Towne Centre Drive • Suite 440 • San Diego, California 92122 • 858-535-1300 • FAX 858-535-1415

December 18, 2003

Retirement Board
San Diego City Employees' Retirement System
401 "B" Street, Suite 400
San Diego, CA 92101

Dear Members of the Board:

Submitted in this report are results of the regular Annual Actuarial Valuation as of June 30, 2003 of the San Diego City Employees' Retirement System. The valuation is intended to provide a measure of the funding status of the retirement system and actuarially computed contribution rates. These rates are higher than rates specified by the Manager's Proposal II. Part of Manager's Proposal II is to use actuarial assumptions used in the 2002 valuation.

Beginning of Year Contributions	June 30, 2003	June 30, 2002
General Members	21.24%	15.50%
Safety Members	41.44%	32.55%
Weighted City Total	27.94%	21.13%

The member statistical data on which the valuation was based was furnished by the Retirement Office, together with pertinent data on financial operations. Data was reviewed for reasonableness, but was not audited by the actuary.

Valuation results indicate that there was a large experience loss of \$312.3 million. This loss represents 9.9% of actuarial accrued liabilities as of the previous valuation date of June 30, 2002. Losses were primarily due to lower investment returns than anticipated.

The cooperation of the Retirement Office in furnishing materials requested for this valuation is deeply acknowledged with appreciation.

Respectfully submitted,

GABRIEL, ROEDER, SMITH & COMPANY

Rick A. Roeder, E.A., F.S.A., M.A.A.A.

San Diego City Employees' Retirement System
Computed City Contribution Rates
 (Expressed as Percents of Active Payroll)

June 30, 2003

GENERAL

General Contributions Based on <u>Valuation of</u>	June 30, 2003			June 30, 2002		
	<u>General</u>	<u>Legislative</u>	<u>Weighted Totals</u>	<u>General</u>	<u>Legislative</u>	<u>Weighted Totals</u>
Normal Cost *	9.76%	18.32%	9.78%	9.26%	21.01%	9.28%
Amortization Payment *	12.21%	49.18%	12.29%	6.75%	43.01%	6.83%
SUBTOTAL	21.97%	67.50%	22.07%	16.01%	64.02%	16.11%
Adjusted for payment at beginning of year	21.14%	64.95%	21.24%	15.41%	61.61%	15.50%

SAFETY

Safety Contributions Based on <u>Valuation of</u>	June 30, 2003	June 30, 2002
	<u>Weighted Totals</u>	<u>Weighted Totals</u>
Normal Cost *	17.70%	17.60%
Amortization Payment *	25.37%	16.23%
SUBTOTAL	43.07%	33.83%
Adjusted for payment at beginning of year	41.44%	32.55%

For Safety members, the 2003, beginning-of-year contribution rates are 41.14% for Police, 42.31% for Fire and 40.38% for Lifeguards.

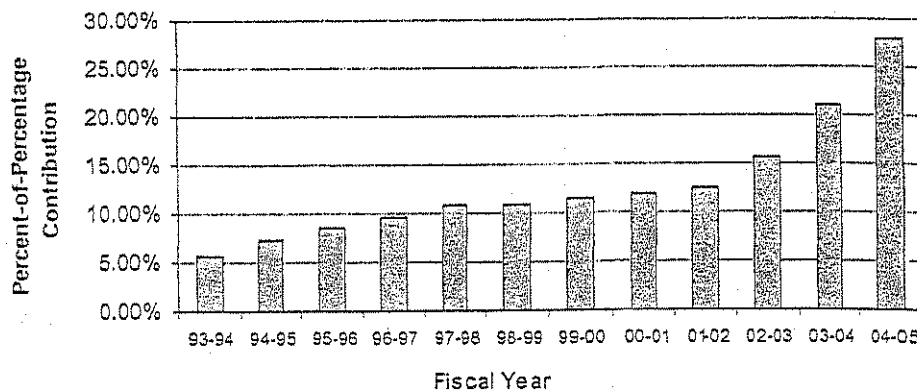
* Rates assume that contributions are made uniformly during the plan year.

San Diego City Employees' Retirement System
Computed City Contributions - Historic Comparison

Expressed as Percents of Payroll¹

<u>Fiscal Year</u>	<u>Valuation Date</u>	<u>General Members</u>	<u>Safety Members</u>	<u>Weighted Total</u>	<u>Valuation Payroll</u>
93-94	6/30/92 ²	2.08%	11.37%	5.67%	\$313,176,024
94-95	6/30/93 ³	3.15%	14.19%	7.39%	\$320,623,685
95-96	6/30/94 ⁴	4.34%	15.42%	8.60%	\$338,440,247
96-97	6/30/95	5.28%	16.42%	9.55%	\$350,583,835
97-98	6/30/96	4.81%	15.20%	8.71%	\$365,088,750
97-98	6/30/96 ⁵	7.35%	16.74%	10.87%	\$365,088,750
98-99	6/30/97	7.52%	16.46%	10.86%	\$382,715,084
99-00	6/30/98 ⁴	7.87%	17.75%	11.48%	\$399,035,094
00-01	6/30/99	8.06%	19.05%	11.96%	\$424,515,968
01-02	6/30/00	5.65%	13.30%	8.35%	\$448,501,827
01-02 ⁶	6/30/00	8.62%	19.83%	12.58%	\$448,501,827
02-03	6/30/01	11.03%	24.48%	15.59%	\$481,863,318
03-04	6/30/02	15.50%	32.55%	21.13%	\$535,156,545
04-05	6/30/03	20.10%	41.44%	27.18%	\$533,595,407
04-05	6/30/03 ⁷	21.24%	41.44%	27.94%	\$533,595,407

Weighted Average Rate for All Groups



¹ Rates shown are adjusted for payment at the beginning of the year and exclude negotiated "pick ups"

² Reflects change in benefits for certain member groups

³ Reflects changes in member contribution rates for certain member groups, early retirement incentive program activity, and methodology with regard to member refunds and employer pickup

⁴ Reflects revised actuarial and economic assumptions

⁵ After Manager's Proposal

⁶ Reflects non-contingent benefit increases

⁷ Includes change in benefits for General Members

PRELIMINARY

San Diego City Employees' Retirement System

June 30, 2003

Elements of Normal Cost

(Expressed as Percents of Active Payroll)

	<u>General</u>	<u>Safety</u>	<u>Total</u>
Service Retirement	15.83%	23.64%	18.41%
Vested Deferred Retirement	1.56%	0.54%	1.22%
Death-in-Service	0.27%	0.57%	0.37%
Disability	2.21%	5.59%	3.33%
Contribution Refunds	<u>0.45%</u>	<u>0.22%</u>	<u>0.37%</u>
Total Normal Costs	20.32%	30.56%	23.70%
Employee Contributions	<u>10.54%</u>	<u>12.86%</u>	<u>11.28%</u>
Normal Costs	9.78%	17.70%	12.42%

(Mid-year contributions assumed for this illustration)

NOTES: In this presentation, Disability costs could be viewed as "overstated" and Service Retirement costs correspondingly "understated" since ALL costs for accrued benefit service are included and encompass those eligible to service retire at date of disability grant.

San Diego City Employees' Retirement System

Development of Actuarial Value of Assets

Year Ending June 30, 2003

(Concluded)

	(a) Net Market Value	(b) Net Book Value	(a)/(b)
1. Market value as a percentage of book value of assets:			
a. June 30, 2003	\$2,463,926,769	\$2,332,055,458	105.65%
b. June 30, 2002	2,326,417,315	2,348,350,495	99.07%
c. June 30, 2001	2,433,217,521	2,341,407,593	103.92%
d. June 30, 2000	2,514,858,618	2,245,019,575	112.02%
e. June 30, 1999	2,196,756,520	1,868,267,506	117.58%
2. Average Percentage for most recent 5-year period			107.65%
3. Current net book value of assets			\$2,332,055,458
4. Preliminary actuarial value of assets: (2)*(3)			\$2,510,457,701
5. Actuarial value of assets: item (4) adjusted to be within 20% of market value			\$2,510,457,701

Valuation assets, for purposes of cost development, were allocated among groups in accordance with their relative proportions of applicable reserves reported at book value.

<u>Member Group</u>	<u>Book Value of Reserves</u>	<u>Valuation Assets Used</u>
General	\$1,159,437,887	\$1,155,876,058
Legislative	3,145,203	3,135,541
Safety	1,220,168,278	1,216,419,883
Total City	\$2,382,751,368	\$2,375,431,482
Unified Port District	125,924,498	125,537,654
Airport Authority	9,517,804	9,488,565
Total	\$2,518,193,670	\$2,510,457,701

PRELIMINARY

San Diego City Employees' Retirement System
Unfunded Actuarial Accrued Liability
June 30, 2003

(City Only)

Derivation of Experience Gain (Loss)

The actuarial gains or losses realized in the operation of the Retirement Association provide an experience test. Gains and losses are expected to cancel each other over a period of years (in the absence of double-digit inflation) and sizable year-to-year fluctuations are common. Detail on the derivation of the actuarial gain(loss) is shown below.

1) UAAL* at beginning of year	\$720,712,870
2) Beginning of year accrued liability payment	8,710,960
3) Interest accrual ((1) - (2)) x .08	56,960,153
4) Increase in DROP Reserves	36,739,604
5) Increase due to General benefit increase 7/1/02	39,182,428
6) Expected UAAL at end of year (1) - (2) + (3) + (4) + (5)	844,884,095
7) Actual UAAL at end of year	1,157,194,039
8) Gain(loss): (5) - (6)	(312,309,945)
9) Gain(loss) as percentage of actuarial accrued Liabilities at beginning of year \$3,168,921,175	(9.9)%

* Unfunded Actuarial Accrued Liability

San Diego City Employees' Retirement System

Unfunded Actuarial Accrued Liability

June 30, 2003

Unfunded Actuarial Accrued Liability

Total actuarial liabilities	\$3,532,625,521
Assets allocated to funding	<u>\$2,375,431,482</u>
Unfunded Actuarial Accrued Liability	\$1,157,194,039

Elements of Experience Gain (Loss)

Estimated Gain attributed to pay increases	\$23,100,000
Estimated (Loss) related to new retirements	(58,500,000)
Estimated (Loss) attributed to investment experience	(286,400,000)
Estimated Gain attributed to post-retirement mortality and data refinement on suspended members	9,400,000
Estimated (Loss) attributed to the "permissive" service purchased during the 2003 plan year for current actives	(5,400,000)
Estimated Gain from employee turnover, pre-retirement mortality and miscellaneous factors	5,490,055
Total Estimated Experience (Loss)	(\$312,309,945)

Experience Gain(Loss) - Comparative Schedule

Valuation Date	Gain (Loss) Gain (Loss)	Beginning-of-Year Accrued Liabilities	Gain (Loss) Percentage
6/30/92	\$57,952,320	\$1,006,299,729	5.8%
6/30/93	(42,605,778)	1,057,238,917	(4.0)
6/30/94	(6,744,850)	1,220,830,059	(0.6)
6/30/95	(11,370,990)	1,338,279,541	(0.8)
6/30/96	59,592,960	1,476,710,662	4.0
6/30/97	38,473,993	1,682,604,532	2.3
6/30/98	31,086,010	1,822,432,018	1.7
6/30/99*	29,750,299	1,979,668,038	1.5
6/30/00	286,639,160	2,181,547,453	13.1
6/30/01	(193,168,984)	2,528,773,900	(7.6)
6/30/02	(364,815,155)	2,809,537,745	(13.0)
6/30/03	(312,309,945)	3,168,921,175	(9.9)

* Beginning with June 30, 1999 valuation, experience schedule is City only.

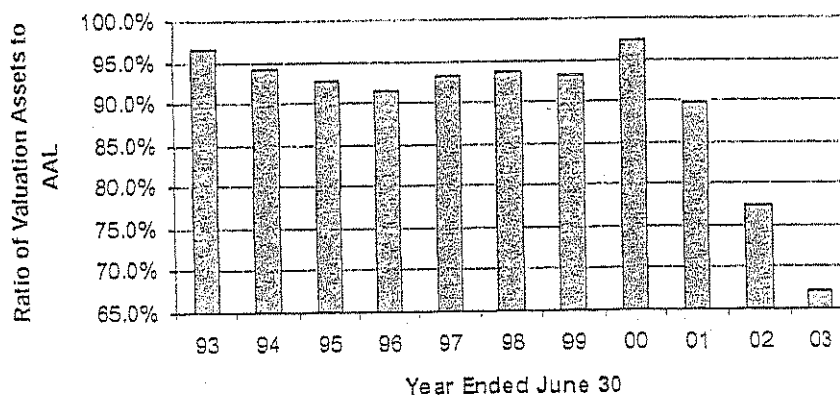
San Diego City Employees' Retirement System
Funding Process Indicators - Historic Comparison
(\$ In Thousands)

Valuation Date	Valuation Assets	Continuation Indicators				
		AAL	Funded Ratio	UAAL	Member Payroll	Ratio to Payroll
6/30/93	\$1,137,019	\$1,178,311	96.5%	\$41,292	\$320,624	12.9%
6/30/94 ¹	\$1,216,063	\$1,290,927	94.2%	\$74,864	\$338,440	22.1%
6/30/95	\$1,316,903	\$1,421,150	92.7%	\$104,247	\$350,584	29.7%
6/30/96 ²	\$1,480,772	\$1,620,373	91.4%	\$139,602	\$365,089	38.2%
6/30/97	\$1,632,361	\$1,748,868	93.3%	\$116,507	\$382,715	30.4%
6/30/98 ¹	\$1,852,151	\$1,979,668	93.6%	\$127,517	\$399,035	32.0%
6/30/99	\$2,033,153	\$2,181,547	93.2%	\$148,394	\$424,516	35.0%
6/30/00	\$2,459,815	\$2,343,400	105.0%	(\$116,414)	\$448,502	(26.0)%
6/30/00 ³	\$2,459,815	\$2,528,774	97.3%	\$68,959	\$448,502	15.4%
6/30/01	\$2,525,645	\$2,809,538	89.9%	\$283,893	\$481,864	58.9%
6/30/02	\$2,448,208	\$3,168,921	77.3%	\$720,713	\$535,157	134.7%
6/30/03	\$2,375,432	\$3,493,443	68.0%	\$1,118,011	\$533,595	209.5%
6/30/03 ⁴	\$2,375,432	\$3,532,626	67.2%	\$1,157,194	\$533,595	216.9%

AAL - Actuarial Accrued Liability

UAAL - Unfunded Actuarial Accrued Liability

Historic Comparison of Funding Value



¹ Reflects revised actuarial and economic assumptions

² Reflects Manager's Proposal

³ Reflects Corbett non-contingent benefit increases

⁴ Includes increase in benefits for General members effective July 1, 2002

PRELIMINARY

San Diego City Employees' Retirement System
Comments & Recommendations
June 30, 2003

COMMENT A: The computed actuarial rate increased from 21.13% to 27.94%, primarily due to significant investment losses. The aggregate actuarial loss was \$312 million dollars, which reflects 9.9% of accrued liabilities as of June 30, 2002. The funded ratio decreased from 77.3% to 67.2%.

COMMENT B: Using the actuarial value of assets, there were investment losses of \$312.3 million. For this purpose, losses are calculated relative to the 8% investment assumption NOT zero. On an actuarial basis, the City's investment return was negative 3.4%.

Unlike the previous two years, the total system return on market value of assets, 4.8%, is higher than the actuarial return of -3.5%. Some slight solace can be found due to the actuarial value of assets exceeds the City's apportioned share of market value (assets are commingled with Unified Port District and Airport Authority) by only \$44 million compared to a difference of \$248 million last year.

COMMENT C: There was an increase in benefits for the General Members effective July 1, 2002 that was included in the valuation. The resulting increase in the contribution rate was 1.14% of General payroll after netting the 0.53% increase in General member rates, effective December 2003.

COMMENT D: There continues to be large increases in the average benefit for new retirees. There were 470 new retirants (which includes those initially electing DROP) with an average annual allowance of \$48,864. The actuarial accrued liability for these 470 retirees is \$313.1 million.

There was a dramatic increase in the DROP program this year from 522 to 732. The annual benefits for the 348 new City DROP members averaged \$53,134, compared to \$50,253 and \$48,443 in 2002 and 2001, respectively.

COMMENT E: At direction from the Retirement Board, we continue to NOT include any Corbett contingent liabilities in the valuation. If we had included the value of such liabilities, estimated to be in the \$70-76 million range, the funded ratio would drop roughly 2%.

San Diego City Employees' Retirement System
Comments & Recommendations
June 30, 2003

(continued)

COMMENT F: The City rate under the Manager's Proposal for the Fiscal year ending June 30, 2003 was 10.33%, which created a significant contribution shortfall relative to the computed rate.

COMMENT G: We recommended that certain non-economic assumptions be adopted based on our most recent experience study. The contribution rate is 28.88% using the new assumptions. We feel that the new assumptions better reflect actual plan experience than the assumptions used for the Manager's Proposal.

COMMENT H: One of the many complexities of the System is that there is a reserve for an Employee Contribution Rate Increase pursuant to the Manager's Proposal, currently \$34.5 million. As such, a small part of this reserve account should be transferred into the Member Deposit Reserve each year to pay for such increase. Our calculations reflect the entire employee contribution amount and are also reflected in the member rates included in the back of the report. As such, we add the following amounts to the rates on data provided us, based on our understanding as to negotiations, pursuant to the Manager's Proposal and Corbett and the new General rate, effective December 2003.

	Manager's <u>Proposal</u>	<u>Corbett</u>	12/2003 <u>Increase</u>	<u>Total</u>
General	+0.45%	+0.16%	+0.53%	+1.14%
Police	+0.51%	+0.16%	-0-	+0.67%
Lifeguard	+0.55%	+0.16%	-0-	+0.71%
Fire	+0.47%	+0.16%	-0-	+0.63%
Legislative	-0-	+0.16%	-0-	+0.16%

San Diego City Employees' Retirement System
Comments & Recommendations

June 30, 2003

(continued)

COMMENT I: The "permissive" purchase service program continues to be very popular. 1,338 active General members have purchased a total of 6,157 years of service. 268 Safety members have purchased a total of 948 years of service.

We anticipate that there will be one more year of losses until the new purchase rates become effective.

COMMENT J: The City is phasing in, over a four-year period, a reduction in the discounts applied to offsets for anticipated saved refunds. Over the four years, the discount will be reduced from 22% to 5% for General members and 7% to 1% for Safety members.

We understand that the City has agreed to increase pick-ups for certain employees. Such increases are not reflected in the 27.94% contribution rate.

COMMENT K: We have been requested to complete an Entry Age Normal valuation annually. This year's Entry Age rate is TBD%.

COMMENT L: The Normal Cost for Legislative members decreased slightly. This year, we are using a 3.50% accrual factor without a 10% assumed pay bump up. The Legislative actives are significantly younger this year which raises the following question: Should we use a maximum projected number of years of service due to term limits?

San Diego City Employees' Retirement System
Summary of Active Members
to be used in the June 30, 2003 Actuarial Valuation

			<u>Averages</u>		
	<u>No.</u>	<u>Annual Compensation</u>	<u>Annual Compensation</u>	<u>Age</u>	<u>Service</u>
SAFETY MEMBERS					
Police					
6/30/2003	1,852	\$121,161,429	65,422	39.7	12.7
6/30/2002	1,914	122,117,880	63,802	39.3	12.3
Percent Increase	-3.2%	-0.8%	2.5%		
Fire					
6/30/2003	746	50,509,743	67,707	40.4	13.3
6/30/2002	766	49,722,904	64,912	41.2	14.0
Percent Increase	-2.6%	1.6%	4.3%		
Lifeguard					
6/30/2003	86	5,026,172	58,444	37.8	8.8
6/30/2002	87	4,825,477	55,465	36.9	7.9
Percent Increase	-1.1%	4.2%	5.4%		
Total Safety					
6/30/2003	2,684	176,697,344	65,834	39.8	12.7
6/30/2002	2,767	176,666,261	63,848	39.8	12.6
Percent Increase	-3.0%	0.0%	3.1%		
Grand Total					
6/30/2003	10,100	\$533,595,405	\$52,831	42.4	11.5
6/30/2002	10,409	535,156,545	51,413	42.4	11.3
Percent Increase	-3.0%	-0.3%	2.8%		

268 Safety members, currently active, have purchased 948 years of service

1,606 City members, currently active, have purchased 7,105 years of service

San Diego City Employees' Retirement System
 Summary of Active Members
 to be used in the June 30, 2003 Actuarial Valuation

		<u>Averages</u>			
	<u>No.</u>	<u>Annual Compensation</u>	<u>Annual Compensation</u>	<u>Age</u>	<u>Service</u>
GENERAL MEMBERS					
General					
6/30/2003	7,406	\$356,055,141	\$48,077	43.3	11.1
6/30/2002	7,632	357,715,723	46,871	43.3	10.8
Percent Increase	-3.0%	-0.5%	2.6%		
Legislative					
6/30/2003	10	842,920	84,292	42.2	10.2
6/30/2002	10	774,561	77,456	46.2	8.9
Percent Increase	0.0%	8.8%	8.8%		
Total General					
6/30/2003	7,416	356,898,061	48,125	43.3	11.1
6/30/2002	7,642	358,490,284	46,911	43.3	10.8
Percent Increase	-3.0%	-0.4%	2.6%		

1338 General members have purchased 6,157 years of service

San Diego City Employees' Retirement System
Summary of Retired Members and Beneficiaries Included
to be used in the June 30, 2003 Actuarial Valuation
(City Only)

The following include DROP Retirements

	Averages						
	<u>No.</u>	<u>Annual Allowance</u>	<u>Attained Age</u>	<u>Age at Retirement</u>	<u>Service at Retirement</u>	<u>New Retirees²</u>	
						<u>No.</u>	<u>Age Allowance</u>
General Members							
6/30/2003	3,223	\$63,212,711	70.2	57.9	n/a	332	\$43,399
6/30/2002	2,999	49,183,256	71.1	58.0	21.7	95	29,808
Percent Increase	7.5%	28.5%	19.6%				
Safety Members							
6/30/2003	2,244	81,703,877	62.9	49.1	n/a	138	62,011
6/30/2002	2,144	72,371,321	63.1	49.2	21.8	73	56,068
Percent Increase	4.7%	12.9%	7.9%				
					6/30/2002 Report	147	31,617
					6/30/2002 Report	145	57,724
6/30/03 Grand Total	5,467	\$144,916,588	67.2	54.2	n/a	470	\$48,864
6/30/02 Grand Total	5,143	121,554,577	67.7	54.2	21.7	168	41,219
Percent Increase	6.3%	19.2%	12.2%				
					6/30/2002 Report	292	\$44,581

¹ Retirees only; beneficiaries excluded

² The 2002 report included DROP members who retired as new retirees since their date of retirement changed when they went from DROP status to retirement. The new data system maintains the original date of DROP so DROP members who retire are not included as new retirees for 2003. The 2002 statistics have been updated for consistency.

San Diego City Employees' Retirement System
Summary of DROP Members
to be used in the June 30, 2003 Actuarial Valuation

	DROP Averages					New DROPS		
	<u>No.</u>	<u>Annual Allowance</u>	<u>Annual Allowance</u>	<u>Attained Age</u>	<u>Age at Drop</u>	<u>Service at Drop</u>	<u>No.</u>	<u>Age</u> <u>Annual Allowance</u>
DROP General								
6/30/2003	347	\$14,809,595	\$42,679	59.7	58.4	n/a	231	58.5 \$47,375
6/30/2002	186	6,068,627	32,627	60.6	58.7	28.0	36	58.5 29,858
Percent Increase	86.6%	144.0%	30.8%					
DROP Lifeguard								
6/30/2003	2	105,565	52,783	51.4	50.0	n/a	1	50.1 55,704
6/30/2002	1	48,883	48,883	50.6	50.0	30.9	1	50.0 48,883
Percent Increase	100.0%	116.0%	8.0%					
DROP Police								
6/30/2003	209	12,995,578	62,180	55.3	53.0	n/a	53	53.0 61,947
6/30/2002	192	11,356,319	59,147	55.5	53.2	26.2	33	52.9 63,417
Percent Increase	8.9%	14.4%	5.1%					
DROP Fire								
6/30/2003	174	11,543,187	66,340	55.5	53.4	n/a	63	53.2 66,796
6/30/2002	143	9,091,921	63,580	55.8	53.5	28.5	17	53.8 67,968
Percent Increase	21.7%	27.0%	4.3%					
DROP Grand Total								
6/30/2003	732	\$39,453,925	\$53,899	57.4	55.6	n/a	348	56.7 \$53,134
6/30/2002	522	26,565,750	50,892	57.4	55.2	27.5	87	55.3 50,253
Percent Increase	40.2%	48.5%	5.9%					

PRELIMINARY

San Diego City Employees' Retirement Association
Comparison of Selected Actuarial Assumptions To Actual Experience

The salary increase assumptions project annual increases in total member payroll of 4.25%, the inflation portion of the individual pay increase assumptions. In effect, this assumes no change in the number of active members. Changes actually experienced in areas related to these assumptions have been as follows:

	Year Ended					3-year	5-year
	<u>6/30/03</u>	<u>6/30/02</u>	<u>6/30/01</u>	<u>6/30/00</u>	<u>6/30/99</u>	<u>Average</u>	<u>Average</u>
Inflation ¹	4.1%	2.9%	5.7%	4.7%	3.4%	4.2%	4.2%
Assumed						4.25 ²	4.25 ²
Average Pay Increase	2.8	5.5	7.7	2.9	3.1	5.3	4.4
Assumed						4.25 ²	4.25 ²
Merit & Longevity Increase	(1.3)	2.6	2.0	(1.8)	(0.3)	1.1	0.2
Assumed						0.5	0.5
Total Payroll	(0.3)	11.1	7.4	5.7	6.4	6.0	6.0
Assumed						4.25 ²	4.25 ²
Investment Return Rate ⁴	(3.4)	(4.1)	4.1	21.4	11.8	(1.2)	5.5
Assumed						8.0	8.0
Real Rate of Investment Return	(7.5)	(7.0)	(1.6)	16.7	8.4	(5.4)	1.4
Assumed						3.75 ³	3.75 ³
Administrative Expenses ⁵	0.3	0.3	0.2	0.2	0.1	0.3	0.2
(Percentage of total assets)							
Assumed						0.0	0.0

¹ Based on Consumer Price Index for San Diego, All Items, 1982-84=100.

² Reduced from 4.5% for 1998 valuation.

³ Increased from 3.5% for 1998 valuation.

⁴ Based on actuarial value of assets NOT market value or book value.

⁵ Excluding Investment Fees.

EXHIBIT 14

From: Lawrence Grissom
To: ddk
Date: 2/12/01 4:22PM
Subject: issues

Dan
Here's the latest installment.

RETIREE HEALTH INSURANCE.

There was a reasonable plan put in place in 1997 with caps and other items intended to control costs. The guess who folks have whined and cried their way back up to where we were prior to 1997. POA and FRA premium costs are now \$5544 annually. Someone is going to have to learn the word "no" and the phrase "OK, so sue me" or this is going to kill the goose that laid the golden egg.

There are two mantras heard continuously from the Coalition. First that the City has guaranteed health insurance to retirees regardless of the cost. Not true. GENERAL MEMBERS were guaranteed the same "choices" in retirement that they had as actives. This was part of the deal for opting out of Social Security in 1981. Did not cover Safety since they never have been under Social Security. Second is that insurance was guaranteed as a part of the Andrews settlement. Again, not true. Yes, they did get insurance coverage as a part of the deal, but not guaranteed as to benefit level. Somehow, this needs to be put to bed. I have tried, Ann Smith has tried, but the filibusterers won't listen.

The third issue is the 1997 "whereas" language and the related MOU's that are said to promise the same "level of benefit". I protested at the time, because the industry is so volatile that there might well be changes in the benefit level that are completely out of our control. That has happened. Witness formulary. Formulary was not in anyone's vocabulary in 1997 and it is industry standard today. The rub comes because the providers will provide you with anything you want in terms of benefits ---- for a price.

I don't know the magic answer. I do think there needs to be some cap on premium for prospective retirees. Remember, current retirees are in fat city ---- they do not need the help, they just whine the loudest.

Refer to the numbers I gave you re: pre 80 health insurance. We are spending roughly \$5 million less annually than the amount IRS will allow us to transfer under the present scheme. Costs since 1997 have tripled from \$2.6 million to \$8 million. We have a surplus of about \$17 to \$18 million projected for the end of next fiscal year. The transfer is contingent upon earnings. IF there are insufficient earnings then the City is on the hook for premium payments. We could last roughly 7 to 10 years under the present scheme with 20% annual increases.

CATCH 22. Am faxing you the reso from the Board on this issue. There are a lot of related issues here that have nothing to do with disability retirement ie departmental use of disability as a disciplinary tool etc. Ron's plan, ie Retirement accepts Worker's Comp medicals cannot work without changes to the Muni Code, and possibly the Charter. This is a benefit issue. Happy to help, but I don't know exactly what you want me to bring to the table.

5 YEAR VESTING Already sent you our stuff on this one.

SUPP COLA. The Retiree Task Force has 3 items here.

1. Remove the 50% cap. This is another one that would benefit the group that needs it most. Actuary has estimated the increased cost at about \$825K annually. Again, this is a frozen group so the cost will decrease each year. I would recommend it. More on financing later.

2. Make the 75% a "permanent" benefit. This has 2 parts.

a. Currently, only those who retired before 7-1-82 are below 75%. By "permanent", the retirees mean that whenever anyone drops below 75%, they would automatically get increased to 75%, ie those who

retired in 83, 84 etc.

b. Some who were increased to 75% have now dropped back below that level, primarily those who retired in 81 and 82. The retirees want it to work so that this group would automatically be bumped back up to 75%.

I would recommend against both of these. Two reasons --- they've gotten a lot in the last few years, most recently Corbett; and Rick has given me factors that show that inflation has not dropped the folks from 83 on below 75% yet, tho they are getting close. The Muni Code requires an annual review of the issue. Best to leave these two items to a future time.

3. The Task Force wants an additional \$50 million from the current year earnings to fund the above. Background --- we set them up with \$35 million, which gets credited with 8% annually. At 12/31/00, the reserve had a balance of about \$31 million. Without any increases, the reserve should last 15 to 17 years. If it were increased by \$50, SUPP COLA would probably last long enough to pay you and me.

CORBETT CONTRIBUTION INCREASE. Ron wants another \$50 million added to this reserve to fund the Corbett employee increase scheduled for 12/31 of this year of (I think, 0.54%). Background. this started with a reserve of \$35 million, credited with 8% and with the restriction that only the interest could be used to fund employee rate increases. You agreed to fund the first round of Corbett increases with the reserve, so we had to lift the restriction. Currently, the cost is slightly more than the interest crediting by roughly \$200K. Translation, no more money is needed for this purpose.

Ron has it in his head that he can funnel this money back into health insurance. Short answer is NO. CERS is a 401(A) trust and health insurance is a 401(H) trust and the funds cannot be comingled. Period, end of story. He will walk the tabletops with the mantra that anything given retirees must result in the actives being given an equivalent amount.

CONNY ISSUE. Rick owes me a pricing. I owe you an AIM. That will be my next #1 priority.

EARLY DROP I would say "over my dead body", but I have a few good years left and don't want to volunteer for anything. This is simply a bad idea. Even if you tie it to 5 year vesting and say 5 at 62 for general and 5 at 55 for safety, it's still a bad idea. DROP is intended for the long term member at the end of the career. If you reduce eligibility, you will provide incentive to retire early, which could result in enormous (read really big) actuarial costs.

Maybe we should talk some more about what you really want to accomplish (I promise to leave my prejudices at the door) and see if we can't find another way to get there.

As they say in the movies "THAAAAAAAAAAT'S ALL FOLKS!"

Let me know what else you might want.

Larry

Lawrence B. Grissom
lbg@sdcity.sannet.gov
(619) 533-4655

EXHIBIT 15

September 22, 2004

**Second Addendum to
Audit of Actuarial Work
San Diego City Employees' Retirement System**

MERCER

Human Resource Consulting

City of San Diego

Reconciliation of Mercer Determination of the Sources of the UAAL to GRS' Determination of the Sources of UAAL

The Board requested that we reconcile the differences between our numbers and those prepared for the Pension Reform Committee by Gabriel, Roeder, Smith & Company (GRS). There are a few areas in which our calculations differ from those of GRS.

Use of Reserves for Additional Benefits

During years in which investment earnings received exceed the amount needed to credit reserves with interest as determined by the Board and the amount needed to pay budgeted expenses and costs of operating the System, under Section 24.1502 of the Municipal Code, the Board can allocate a portion of those investment returns to pay for additional benefits including retiree medical benefits, supplemental benefits for retirees, and increased benefits pursuant to the Corbett Settlement. This use of earnings to pay for additional benefits prevents those earnings from being used in future years to offset low investment earnings. Because these benefits are not reflected in the actuarial valuation, the funding of these benefits reduces the overall funded status of the System. The use of excess returns to provide benefits is the same as providing a benefit improvement.

In order to determine the amount of the UAAL which is the result of the transfer of reserves for additional benefits, we summarized the impact of transferring "excess" asset returns to cover contingent benefits which are not pre-funded as part of the actuarial valuation. We determined that approximately \$300 million of the current UAAL is the result of transferring earnings for these contingent benefits. In their evaluation, GRS shows a smaller number of around \$141 million. The difference between these two numbers is in how you determine the value of the additional benefits. GRS is considering only those benefits which have actually been paid to members. Our number reflects any assets which are transferred. Thus, any asset reserves that are held for these benefits over and above what has already been paid are reflected in our numbers and not in GRS' numbers.

We believe that our methodology provides the most accurate reflection of the contingent benefit costs because according to our understanding those assets will eventually be paid as contingent benefits and will not be used to provide vested pension benefits. This is particularly true for assets transferred to pay for retiree medical benefits under Internal Revenue Code Section 401(h). In this case, there are specific restrictions on the use of those assets. There may also be similar restrictions for other reserves. The evaluation of such restrictions is outside of our scope and expertise. However, we believe that based on our experience, the assets which have been transferred will not be returned to pay for pension benefits.

Finally, our determination of the "contingent benefits" funded by reserves includes a recognition of \$34 million which was transferred during the plan year ending June 30, 1999, for STAR COLA benefits and \$8 million transferred in the plan year ending June 30, 2000. Based on our understanding, the STAR COLA program is not prefunded and assets were transferred from pension reserves to fund the STAR COLA. We have categorized this as a transfer of funds. This benefit could also be considered under the benefit improvement category.

Based on information provided by Rick Roeder of GRS, we are able to match the numbers determined by GRS.

Contribution Shortfall

Based on our understanding of the Manager's Proposals, we understand that during the plan year ending June 30, 1997, the City contributed at a rate of 7.33 percent of pay. Our evaluation of the contribution shortfall reflects this undercontribution during this year. In evaluating the cost of the undercontributions, GRS did not reflect the 7.33 percent contribution in PYE 1997.

Differences to Our Prior Report

During the process of reconciling our results with those of GRS, we uncovered some areas in which our information was incomplete. Thus, some of our results have changed somewhat from our prior report.

Benefit Improvements

Based on the June 1, 1997, Actuarial Valuation Report, we started our analysis as of June 30, 1996 but after the implementation of benefit improvements. These benefit improvements increased the UAAL at that time by \$82.5 million. Our revised report includes the \$82.5 million improvement during 1996.

In their evaluation of the cost of benefit improvements, GRS included the increased normal cost amount. We concur that this is an accurate reflection of the cost of a benefit improvement and have incorporated that change in our results.

Asset Returns

Based on additional information provided by GRS regarding the employee contributions, we revised our asset return numbers. We revised our assumption regarding the timing of contributions to be beginning of year rather than throughout the year. Also, we increased the employee contributions to more accurately reflect the employer pickup.

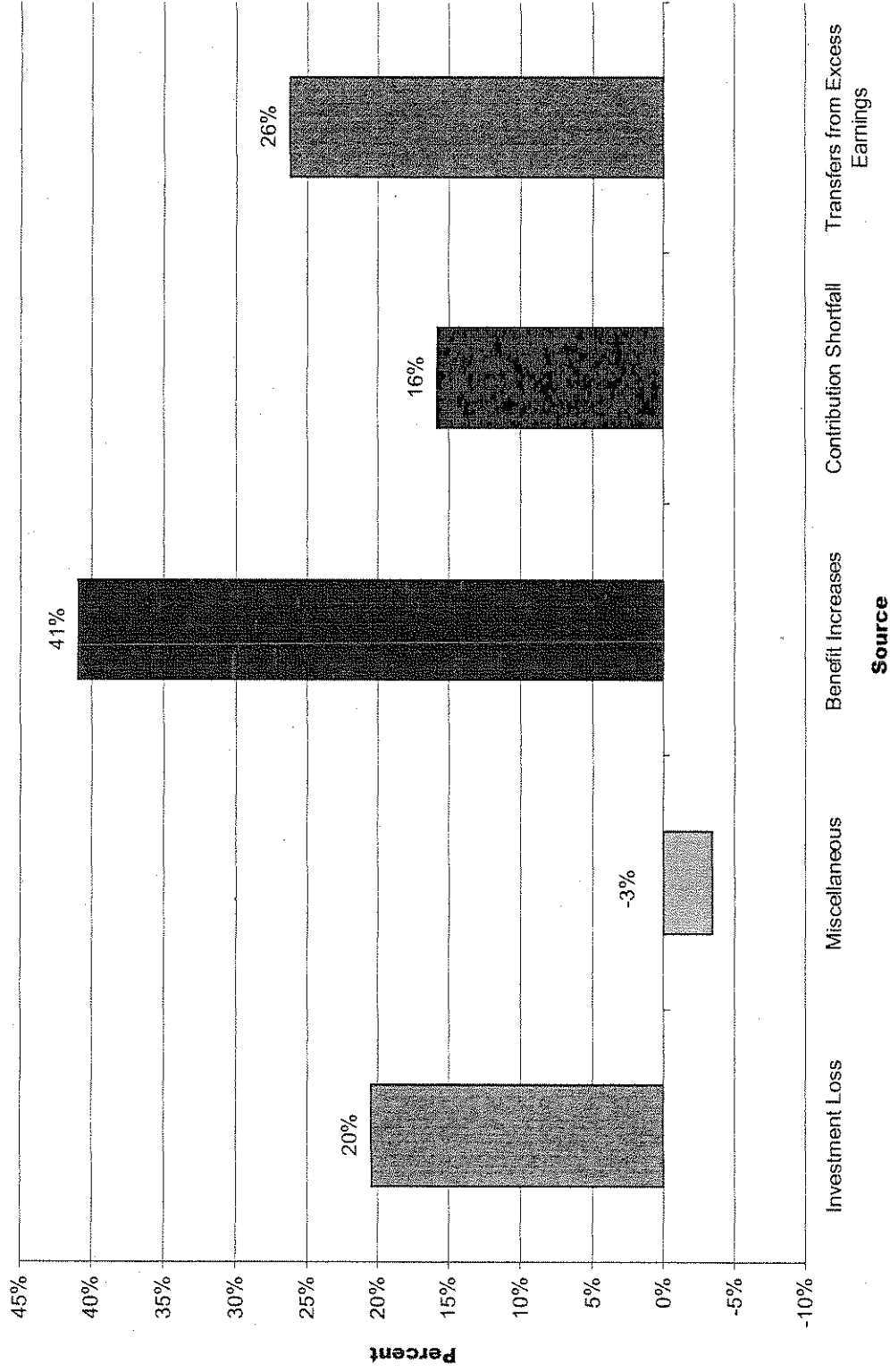
Year by Year Analysis

The Board also requested that we evaluate the gains and losses by year. The following chart shows these results.

Exhibit 1
City of San Diego
Year by Year Development of Gain/Loss

	Plan Year Ending (in millions)					
	1997	1998	1999	2000	2001	2002
Beginning Unfunded	\$57	\$106	\$122	\$148	\$69	\$284
Expected Amortization of Unfunded	3	7	8	10	5	20
Interest	4	8	9	11	5	21
Expected Unfunded	58	107	123	150	69	285
Benefit Levels	83	-	-	186	-	-
Asset Performance	(102)	(72)	(15)	(263)	105	315
Use of Reserves for Additional Benefits	50	53	55	54	-	-
Contribution Shortfall	13	12	13	14	15	29
Assumption Changes	7	25	-	-	-	-
Data Corrections	-	-	-	-	-	78
Non-asset experience	(3)	(3)	(27)	(71)	95	14
Actual EOY UAAL	106	122	148	69	284	721
						1,157

Exhibit 2 Sources of UAAL



DROP Evaluation

Effective April 1, 1997, a deferred retirement option plan (DROP) was added to the benefits available to members covered under the San Diego City Employees' Retirement System. Under the provisions of the DROP plan, members cease to accrue additional benefits under the Plan and accumulate a lump sum benefit payable at their actual retirement. According to Section 24.1401 of Article 4 of the Municipal Code, the DROP program is intended to be cost neutral.

The Retirement Board has asked Mercer Human Resource Consulting to evaluate the cost-neutrality of the DROP program. It must be noted that the determination of cost-neutrality is heavily dependent on the assumptions used to determine the value of benefits. In our evaluation, we used the actuarial assumptions used for the valuation.

Basis of Evaluation

Actuarial Assumptions

For the purposes of our evaluation, we used the actuarial assumptions used for the June 30, 2003, actuarial valuation. This includes the investment return assumption of 8 percent and a salary increase of 4.5 percent. We assumed that the DROP account will be credited with 8 percent returns.

Plan Provisions

When a member enters the DROP program, that member agrees to retire within a period of 60 months or less. At that time, the member designates a beneficiary, elects a form of retirement benefit, and stops accruing benefits under the Plan. Employer and employee contributions cease at that time as well, except as noted below.

While the member is in the DROP program, the following payments are deposited on account for the member:

- Retirement Benefits, according to the members elected form of benefit payment,
- Cost-of-living increases on the retirement benefit,

- The annual supplemental benefit based on service at entrance to the DROP,
- 3.05 percent of compensation paid by the city,
- 3.05 percent of compensation paid by the employee, and
- Interest on all of these amounts.

Results of Evaluation

For a DROP program to be cost-neutral, the value of the additional benefits earned by a continuing employee who does not choose DROP must exceed the value of the benefits paid to the DROP account during the DROP period or the existence of the DROP program causes a delay in the retirement age that offsets the value. Our evaluation focuses on the cost to the employer of the DROP benefit rather than on the value of the DROP benefit to a particular individual employee. Clearly the two calculations are related.

Based on our evaluation, for Safety members, the DROP program is not cost-neutral. For a member who enters DROP at age 53 with 26 years of service (the averages reported in the June 30, 2003 actuarial valuation) and remains in the DROP program until age 58, the value of the DROP benefit is 115 percent of the value of the benefit he would have earned by continuing to accrue service and pay increases. This is caused by the fact that while his benefit does indeed increase if he does not enter DROP, those increases are not sufficient to offset the value of the benefits paid into the DROP account. In addition, we evaluated the benefits at other age and service combinations. For the age and service combinations that we evaluated, the DROP program is more valuable than continuing to work. Only in the vent of a member who enters DROP with very low service will the DROP program be less valuable.

Because the benefit structure is very different for the General members, we evaluated the cost of their benefit separately. The average age of a General Member entering DROP is age 59 and those members have an average of 28 years of service. For the average general member entering DROP, the ratio of the benefit value including DROP to the benefit value if the member didn't enter DROP is 111 percent at the end of the maximum DROP period. This ratio is lower because General members tend to enter DROP later and have a smaller benefit formula. Similar to Safety, the DROP program is always more valuable except in the case of members with very low service.

Many times DROP programs are implemented with certain workforce management goals in mind. For example, an employer might find that valuable, experienced employees are financially motivated to leave employment in order to receive retirement benefits. A DROP program might be a way to keep such employees working for a period of time. Our calculations do not take into account the financial or other advantages that might be realized with the implementation of a DROP program.

Funding Considerations

Your actuary treats a member who entered DROP as retired at the time entry into the program. This is a reasonable methodology for treating DROP members and is consistent with the practices of the System.

In addition to the cost of benefits to an individual, when a member enters the DROP program, contributions are no longer made on that employees' pay. Because of this, the base compensation on which the contribution rate is determined will be smaller, driving up the annual cost as a percentage of payroll. Indeed, if members who would otherwise have continued to work elect the DROP program, the annual cost for those employees increases because that cost must be paid over a shorter period of time.

The actual age at which employees retire impacts the costs as well. If employees who would otherwise have retired enter the DROP program, the "cost" to the plan is minimal. However, if employees who would have continued to work elect to enter the DROP program, the plan experiences cost increases due to the shorter time period over which to pay for benefits and the increase in the value of the benefits to the member due to DROP.

If the DROP program has caused a delay in retirement age then this would offset the costs of the additional benefits. A separate study would be required to evaluate this.

EXHIBIT 16



Evaluating the Financial Impact of DROP City of San Diego

December 7, 2004

In evaluating the cost or savings associated with DROP, there are two ways to do so:

- 1) Calculate the impact on the present value of benefits provided members
- 2) Calculate the impact on near-term contribution levels.

We believe the first way to do so is clearly best. Near-term contribution levels can be misleading. For example, City contributions are based on valuation payroll excluding DROP. In the short-term, lowering payroll will likely lower short-term contribution levels but could increase them in the long term due to the added potential costs of amortizing larger amounts of unfunded liability. Our earlier 2004 correspondence on DROP, "The Knowable, the Misleading and the Unknown," addresses this.

There are two basic ways that DROP service can be reflected in actuarial computations:

1. Treat the DROP recipients as retirants at the point that they elect to DROP.
2. Treat the DROP recipients as actives for an average assumed period beyond their DROP date.

In the City of San Diego valuation, we are using Method #1 and treating the DROP recipients as retirants. Our rationale is based on the adage that if it "walks like a duck and looks like a duck, it probably is a duck." Like retirants, DROP members accrue no further benefits (except for the 3.05% of pay the City annually adds to their account).

Also, the City uses the Projected Unit Credit actuarial funding method. This funding method is not conducive to treating DROP in any other manner. Last, DROP members do not pay contributions.

We wish to emphasize that this study will have the following substantial limitations:

DROP cost/savings to SDCERS will depend, in large part on its impact on retirement ages. It is impossible to isolate the impact of DROP with 100% certainty. There may be other factors which have impacted retirement incidence since DROP's inception in 1997.

DROP retirants tend to have significantly longer service than non-DROP actives at their age. Particularly for Safety members, there will be some impact on DROP election which relates to the 90% cap on final average compensation. It is difficult, if not impossible, to isolate the impact of DROP from the impact of the cap. For Safety members, DROP and the 90% cap were implemented at the same time.

There is greater financial incentive to DROP than existed at plan inception in 1997. This is because the current benefit formulas provide less incentive to work later and accrue additional benefits than in 1997. For General members, there is no increase in the 2.5% multiplier until age 60. Since the median retirement age falls in this range, this will impact most. For Safety members, the 3% multiplier is in place at age 50. Further, those Safety members who reach 30 years of service will hit the 90% cap and have even less incentive not to DROP.

Given the Projected Unit Credit funding method, we believe the average period of DROP service is not as relevant as it might initially seem. We are funding to the beginning, not the end, of the DROP period. Second, to the extent that it encourages those to work longer than they would have in a non-DROP environment, as assuredly would be true in a number of instances, it will be very difficult to meaningfully compare this to working lifetimes prior to DROP.

We have tried to isolate the impact of the DROP program on the change in the calculated actuarial rate for the 1998 valuation. We initiated this because of our efforts to reconcile the difference between the 1997 and 1998 contribution rates. We are asking for input because of the complexity surrounding these calculations and the political sensitivity due to the DROP program's interim status.

As our starting point, we first looked at averages for DROP recipients as retirants and valued a liability associated with their retired status. We based our calculations on the average retirement age and credited service during the past seven years, but calculated and used an average compensation from the 2004 retiree data. See Appendix A. It is important to recognize that the seven-year average compensation is not as relevant to a current evaluation due to benefit increases during this period. See Appendix A. Also, our analysis uses current benefit formulas.

	<u>Total Number of Drop Members</u>	<u>Average Annual Allowance</u>	<u>Average Retirement Age</u>	<u>Average Years of Credited Service</u>
General	701	\$38,186	58.7	28.0
Safety	677	\$57,193	53.4	27.0

49% of General retirees (59% on a dollar-weighted basis) during this period elected DROP. 72% (79% on a dollar-weighted basis) of Safety retirees elected DROP. Thus, those with longer periods of service were much more likely to elect DROP than those with shorter service. In the past two years, such percentages have been even higher. The average length of DROP service was 3.6 years for Safety members and 2.3 years for General members.

Under the current actuarial assumptions to determine computed rates, the median retirement age is 59 for General members and 55 for Safety members. Thus, one can say that it does not appear that DROP has had a large impact on DROP election ages relative to what the actuarial model incorporates. The 53.4 figure for Safety members is slightly lower than the median. This may be caused by the 90% cap inducing younger hires to DROP as soon as they hit the cap.

Using the retirement age, years of credited service, and the average compensation, we calculated the Present Value of DROP benefits for such hypothetical average member and compared them to what would have happened under three scenarios:

1. The member would have retired immediately as a non-DROP member; or
2. The member would have worked for two more years then retired; or
3. The member would have worked for four more years then retired.

While there is no normal cost for members in DROP, we have added in the City 3.05% additional contributions during their assumed average DROP period. In all Scenarios, we calculated the Present Value of Benefits as of the beginning of the DROP period.

SCENARIO #1: Compare to immediate non-DROP retirement

	<u>Initial Annual Allowance DROP</u>	<u>Initial Annual Allowance NO DROP</u>	<u>Present Value of Benefit DROP</u>	<u>Present Value of Benefit NO DROP</u>
General	\$42,538	\$42,538	\$579,000	\$575,000
Safety	\$70,270	\$70,270	\$1,020,000	\$1,011,000

Under this Scenario, the present value of benefits increases by 0.9% for Safety members and 0.7% for General members. In this scenario, all the added present value of benefit is due to the 3.05% contribution made by the City. The 3.05% contribution is NOT part of the actuarially computed rate.

SCENARIO #2: Compare to two years of added non-DROP service

	Initial Annual Allowance <u>DROP</u>	Initial Annual Allowance <u>NO DROP</u>	Present Value of Benefit <u>DROP</u>	Present Value of Benefit <u>NO DROP</u>
General	\$42,538	\$51,509	\$579,000	\$575,000
Safety (no cap)	70,270	88,435	1,020,000	1,063,000
Safety (cap)	70,270	83,446	1,020,000	1,003,000

This indicates that the present value of benefits again increases by 0.7% for General members. For Safety members, there is a 1.7% increase in the DROP benefit for those subject to the 90% cap but a 4% reduction for those who still have not hit the cap.

SCENARIO #3: Compare to four years of added non-DROP service

	Initial Annual Allowance <u>DROP</u>	Initial Annual Allowance <u>NO DROP</u>	Present Value of Benefit <u>DROP</u>	Present Value of Benefit <u>NO DROP</u>
General	\$42,538	\$62,627	\$579,000	\$572,000
Safety (no cap)	70,270	101,736	1,020,000	1,038,000
Safety (cap)	70,270	91,562	1,020,000	916,000

This indicates that the present value of benefits again increases by 1.2% for General members. For Safety members, there is an 11.4% increase in the DROP benefit for those subject to the 90% cap but a 1.8% reduction for those who still have not hit the cap.

* * * * *

We have one comment on the interest crediting rate of 8% during the DROP period. If SDCERS really believes that a long-term rate of 8% is achievable after the netting for administrative expenses and contingent benefits, then this should be reasonably close to cost neutral. They probably will be some anti-selection against the System in that SDCERS may have more people maintaining DROP accounts during periods of perceived low investment return in alternative investment vehicles. Overall, we do not see this element as having a significant cost impact if 8% is a reasonable, long-term assumption.

CONCLUSION: Based on our approach of using average age at DROP, the cost of the DROP program appears to be slight enough not to have been a major cause for the contribution increases of recent years. There only appears to be significant cost for capped Safety members -- the DROP program allows them to accrue more additional value than if they did not DROP. One could argue that this element is attributable to the cap and not the DROP.

If we did an individual-by-individual analysis for each DROP member along the lines of what we did in aggregate, on a going forward basis, we would expect the cost of DROP to be slightly higher than demonstrated in our analysis. First, the benefit formulas have changed enough such that there are more years where there is no "carrot" of a higher benefit multiplier at the next succeeding retirement age than when DROP was implemented in 1997. Also, averages do not fully capture "outlier" situations where there would be more financial incentive to DROP than for the hypothetical average member in our model (ie, a 55-year-old General member who would not have their 2.50% benefit multiplier increased unless they worked another five years).

Finally, our analysis indicates that the additional cost for the DROP program appears to be less than what was indicated in Mercer's actuarial audit.

Sincerely,

Rick A. Roeder, EA, FSA, MAAA

EXHIBIT 17

For purposes of today's meeting, Mr. Pierce said he would take the earnings issue out of order.

**IX. QUESTIONS & COMMENTS FROM PRESIDENT, TRUSTEES, ADMINISTRATOR
ATTORNEY – None.**

X. CLOSED SESSION – None.

XI. ADMINISTRATOR'S PERFORMANCE REVIEW

This item was trailed to the May 2002 meeting.

**XII. RECOMMENDATIONS AND REQUESTED ACTION FROM THE SUBCOMMITTEE
REGARDING EARNINGS**

Mr. Pierce said this is a very important issue this year. As such, a Subcommittee was formed to address the issues and has met on several occasions. He asked that the Board allow Staff to fully present the Subcommittee's report before asking questions and to reserve their comments to the end.

Mr. Grissom provided a detailed presentation of the Subcommittee's review and recommendations. A copy of his presentation material is included as Attachment A of these minutes.

Mr. Pierce said when the Committee was formed, one of the things the Board had asked was what its legal authority is with respect to earnings under the Municipal Code. On the advice of fiduciary counsel, the Committee took into consideration what actuarial implications any of its recommendations would have on the fund and which of these actions would serve to dilute the funded ratio of the system. The Committee looked at this while taking into consideration the Board's comments that it wanted to send a clear message that it would no longer finance benefits formulated under the Manager's Proposal. Right now, the actuarial funded rate is at 15% and the System is closer to receiving 10%, which increases at 50 basis points per year. This is the ten or eleven years discussed by Mr. Grissom. If the Board overlays some of these actions to dilute the funded ratio, the projections could go from 15% to 19% and it could be anywhere from 15 to 20 years out before the cross over under the Manager's Proposal occurs. As he understood at the recommendations of the Subcommittee, the following items would essentially reduce the funded ratio of the System: 1) crediting of the interest on the DROP accounts as a vested benefit, which is a requirement of the Municipal Code, which is about \$5 million; 2) funding the budget if there are not sufficient earnings, which is about \$21 million, and under the assumption that some earnings would stay with the System. Adding these two together is about \$26 million or 1%, which would take the 89% funded ratio to 88%. He added that there is the fact that there is a difference between the assumed rate and what the System actually earned this year, so that when the books are closed at the end of the year, this will be evaluated on a five-year smoothing basis. By adding the first two items with this and holding everything else constant, we are looking at the 84% to 85% range based on the Subcommittee's recommendation. This is an important threshold because the 82% level would trigger the City's payments to the accelerated, full actuarial rate.

Mr. Grissom said that a funding ratio of 84% is probable and could actually be worse due to actuarial losses on investments for the '02 fiscal year.

Mr. Casey said he didn't realize the System had reached such doom and gloom. He said he has seen in writing that the Board has the authority to set up reserves as it deems appropriate. It makes no sense to state we can set up reserves but not be allowed to spend them. This is an implied authority as far as he's concerned. Secondly, it points out that whether or not the System had a bad year the idea of using realized gains as a mechanism for funding this operation and pay bills has been around way too long. It's not good in his opinion. Theoretically, it's possible to have a stellar year and for all of the System's managers to underperform and the System could have a negative realized gain and not be able to pay its bills. This doesn't make sense.

Mr. Grissom said this happened in 1990. The System had a total return of plus 9, but didn't have sufficient earnings to pay the 13th check.

Mr. Casey said money was taken from that reserve then to pay the 13th check.

Mr. Grissom said this came out of the Andrew's lawsuit settlement, which carried with it the authority to spend undistributed surplus earnings on a one-time basis.

Ms. Webster asked Mr. Blum if Hanson Bridgett has opined that the Board doesn't have discretion to use different rates.

Mr. Blum said the short answer is yes.

Ms. Webster asked if the Board could use an 8% actuarial assumption rate and credit the accounts with 6%.

For the Board to do this, Mr. Blum said it would be a major fiduciary decision that would require in-depth evaluation. The consequences to the City, all its members, the retirees and the funding status would have to be reviewed. After reviewing all of these issues, if the Board wished to do this, he would strongly recommend that the Board set a policy as such. Otherwise, the Board and this System would be extremely vulnerable. If the Board sets a long-term interest crediting policy, he believes the Municipal Code gives them the authority to do so.

Mr. Pierce said there was one provision of the Municipal Code that stipulated for at least one account that the crediting must be on the earnings assumption rate.

Mr. Grissom said this is stipulated in 24.0103. He read that the undistributed earnings reserve shall mean the balance remaining in the account to which the earnings to the fund are credited after the annual distribution to the employee and employer reserve accounts in accordance with interest assumption rates established by the Board. With the Board's past practice and prudence, if the Board were to change the crediting

rate, it should also change the assumption rate. If the Board changes its assumption rate, it would impact a number of things.

In response to Ms. Webster's question about crediting at different rates, Mr. Blum said in his review of 24.0103 and 24.0105, it appears that historically and through Board policy the Board has read these sections together. If this is a fair statement, then in fact, the interest assumption rate is the rate that should be credited. However, if he reads these two sections separately and word for word, he believes it is appropriate for the Board to go through its fiduciary investigation to determine whether they could credit these accounts at different rates on a long-term basis.

Mr. Pierce said two things came up that surrounded this issue. One had to do with the Board's fiduciary duty. Trying to justify other than the long term earnings assumption rate than these accounts were essentially set up to pay the long-term liabilities of the fund and would require a very clear and sound approach. On the employee contribution reserve account, if the Board were to credit less than the actuarial rate and a long term City employee left City employment, they could be damaged. Secondly, to the extent the reserves are credited at the actuarial assumption rate, it keeps that money inside plan assets, which bolsters the funded ratio of the System. If these reserves are credited at any lower interest rate, it allows earnings to drip down the distribution to pay contingent benefits. The Subcommittee did not believe it would be fiduciarily sound to allow certain contingent benefits to be paid when those assets can be kept inside plan assets and bolster the funding.

Mr. Blum said these types of examples would have to be evaluated by the Board. If the Board agrees to lower its interest rate to provide more money to pay contingent benefits, it would essentially be pulling money out of the System, which would weaken the financial status of the fund.

Ms. Webster asked what the actuarial impact would be to lower the interest rate from 8% to 6% and to credit the employer and employee reserves with 6%.

Independent of the valuation, Mr. Roeder said the biggest impact isn't the interest rate used to credit the reserves, but what buckets of money are being excluded and included in the plan assets.

Ms. Webster asked what would happen if the employer reserve were credited with 6%, which is within plan assets.

Mr. Roeder said if the two reserves are in plan assets and the Board was to transfer money from one reserve in plan assets to another reserve in plan assets, there would be no actuarial impact.

Mr. Pierce asked if there would be a zero actuarial impact if there are not enough earnings to flow past that first crediting to pay for the budget.

Mr. Roeder said he believes so.

Mr. Pierce stated that earnings are plan assets. If the reserves are credited at 8%, they stay in plan assets.

Whether there is \$10 million in surplus or \$500 million in surplus, Mr. Saathoff said these are considered assets as long as everything stays within the plan assets.

Ms. Webster said the Committee is recommending that the Board continue with the 8%. It is her goal as a fiduciary to the fund and to the plan sponsor not to impact the funding ratio any more than necessary. Therefore, she would recommend crediting less than 8% to the employer, employee and DROP reserve accounts.

Mr. Pierce said it is a Municipal Code requirement that DROP be credited from plan assets and has nothing to do with earnings.

Mr. Grissom said Mr. Pierce is correct. There is nothing in the Municipal Code that would allow the DROP account to be credited at a lower interest rate.

Mr. Blum said there are very specific reserves, not in plan assets, where the interest crediting regardless of the amount, will not affect plan assets either in or out for purposes of the valuation.

Mr. Roeder agreed. Currently the Board is holding \$3.7 million outside of plan assets.

Mr. Saathoff said the 13th check is a contingent benefit. By not crediting the reserve accounts, it would keep the money in the fund for purposes of the valuation. By not making that credit, that money would flow to an account and leaves plan assets, which clearly affects the valuation of the System. The same is true with funding the health insurance trust. The money is transferred off book and lowers the assets and funding ratio of the System.

Mr. Roeder agreed with regard to the 13th check.

Mr. Blum recommended reviewing each of the reserves. With regard to DROP, it was reported that these assets are held outside the pooled assets used for valuing the System. This affects the valuation of the system.

System. Interest must be credited to the DROP accounts. What has not been addressed is that both DROP assets and DROP liabilities are taken out of the valuation. When the Board adds interest crediting to the DROP accounts and takes those assets out for purposes of the valuation, it simultaneously takes the additional liabilities out for purposes of the valuation. Therefore, this results in a non-event. The reserves listed on Page 24 of the Gabriel, Roeder Smith report include one reserve that reflects \$225 million. However, he understands that this really is a non-reserve. The second reserve is for supplemental payments, including the 13th check. This reserve is now held outside of the assets for purposes of the valuation and no interest is to be credited to that reserve. He also understands that this reserve could be used to pay the 13th check if City Council so approves.

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Mr. Pierce said if the City Council directs the Board not to pay the 13th check, then based on the Committee's recommendation to move this reserve inside plan assets, it would increase the funded ratio.

Mr. Blum agreed. The next reserve deals with health insurance and post retirement health care and equals \$20,000. ~~Both of~~ These are held outside of assets for purposes of the valuation and do not affect the funded status ratio and will not be credited with interest. However, because the Municipal Code states specifically that retiree health benefits shall be paid from the 401(h) fund, they ~~can't~~ will be used to pay that benefit. Next is the DROP reserve, which is an actuarial non-event. To follow is the employee contribution rate increase reserve, which is \$12 million. Lastly is the Supplemental COLA reserve, which the Municipal Code requires be used for the Supplemental COLA and is taken off book. The Board could legally credit the DROP accounts at a lower interest rate, but he believes the Board would have a vested rights issue in so doing and could set itself up for a lawsuit.

If there were different interest crediting rates, Ms. Webster asked if different amounts of money would be moved off book.

Mr. Blum said "No."

Ms. Webster said she is talking about distributing it among different accounts.

Ms. Wilkinson said the actuarial report lists seven different accounts to be used for various purposes. Mr. Grissom listed four additional reserves.

Mr. Grissom said the ones he listed are held outside plan assets.

Ms. Wilkinson said she recalled one reserve being created to fund the 115 trust.

Mr. Pierce said it was mentioned, but wasn't specifically set up for that purpose.

Ms. Lexin said she understood that the \$100 million that was set aside was to be used to fund the 115 trust.

Mr. Pierce said the Board didn't make a decision for actually allocating those funds. If the accounts were consolidated as in Recommendation #8, Ms. Webster asked if this would prohibit the City Council from transferring money from the employer reserve to fund the 13th check if they voted to do so.

As the plan sponsor, Mr. Grissom said City Council could do this.

Ms. Webster said there is no disadvantage in respect to consolidating all of these small reserves into the employer reserve. This would allow the plan sponsor to use these reserves to confer and pay for new benefits if they so choose.

Mr. Grissom said this is correct, with the exception of the health care reserve.

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Mr. Grissom said this is correct, with the exception of the health care reserve.

Ms. Webster said Recommendations #3 and #5 could negatively impact the funded ratio. Therefore, she wouldn't consider either of them.

Mr. Pierce said if the Board chose to credit the DROP account at zero, it would not leave plan assets. If the Board chose to credit it at 8%, \$5 million would leave the System.

Mr. Blum said there is a vested benefits issue with this.

Mr. Roeder said this is a legal versus actuarial question. If the DROP reserve were credited with zero and \$5.2 million remained in plan assets, the DROP reserve would be \$5.2 million less than it would have been. This would result in \$5.2 million being excluded from plan assets.

Ms. Wilkinson said if the Board decided not to credit the DROP account, the Board wouldn't be creating that liability.

Since this account must be credited according to the Municipal Code, Mr. Blum said it is not an issue and should be put to rest.

With respect to Recommendation #10, Ms. Webster asked if the Board could unilaterally not roll any new benefits into the Manager's Proposal.

Mr. Blum said the issue with this is that the Manager's Proposal may have been interpreted different than the intent. The Board might need to go back and review the Manager's Proposal and inform the City that this was not the intent of the Proposal. The Board's role is to look at its liabilities and determine what the costs are and set the contribution rates within the context of the Manager's Proposal. It is within the Board's purview to insure the City understands what the Board originally agreed to.

Mr. Vortmann asked if the Board has a responsibility to tell the City what must be paid as sound actuarial crediting.

Mr. Blum replied, "Yes." The Board needs to determine if there is a widening gap and if it can live with that gap.

Mr. Saathoff said under the Manager's Proposal, the City's rate increases were capped at 0.5% per year.

Ms. Webster said it is tough to explain earnings globally. The whole concept of distributing earnings requires the Board to determine what its earnings are. The recommendation the Committee is proposing starts out with \$43 million. She questioned how the Board can distribute earnings it doesn't have.

Mr. Pierce said the Board would only spend what is available from earnings. The rest would come from plan assets to fund the other things required under the Municipal Code.

Mr. Vortmann said the employer reserve would be used as a last account and would be considered a balancing account.

Ms. Wilkinson said more money is pouring into the employer reserve than is needed.

The Board's obligation under the Municipal Code is to credit interest. Mr. Blum said there is no connection with the financial reality, but there is a connection between what this Board is required to do. This has caused a significant amount of confusion. The bottom line response is that the Municipal Code was not written for this circumstance and needs to be changed. It is for this reason that the Committee is recommending that the Board get rid of these reserves.

Mr. Grissom said he believes there has come a perception over the years that earnings are cash in pocket, which is not the case. The Board has overlaid a cash basis of earnings distribution on a total return basis of its investment program. The Board needs to change this because it doesn't work.

Ms. Webster said it seems that revenue comes from the investment earnings. If not, she asked where the revenue comes from.

Mr. Blum said in reality, revenue doesn't come from investment earnings. Unfortunately, the Municipal Code wasn't written to deal with this type of situation, which is why the Board is in the position it is in and supports why the Board should follow the Committee's recommendations. He reminded the Board that this is a defined benefits plan and the System needs to make sufficient earnings to pay the benefits.

Ms. Webster said this goes against Section 24.1502.

Mr. Roeder said the code was drafted when fixed income, assets and volatility were very small and under very different times.

Ms. Shipione said the Board should look at its assets and the liabilities that will grow over time. If the plan can grow at 8% and there is a deficit, the money needs to come from somewhere. She said it is time to correct the situation and for the Board to determine whether there is something more that can be done now.

Mr. Pierce stated that the Committee was established first to deal with this year. However, it will also be looking at a long-term solution.

As for the longer term, Mr. Roeder said the Board would be doing an experience investigation this year, which will include a look at the System's actuarial assumptions.

Mr. Grissom said Ms. Shipione is correct that this is a step in the right direction.

If the System remains whole and pays its liabilities, Ms. Shipione asked how much would be needed from the City.

Mr. Roeder said this is calculated each year.

Mr. Vortmann informed Ms. Shipione that the answer to her question is on Page 11 of the actuarial valuation. Additionally, City Council has mandated that the Board to try to explain much of what Ms. Shipione is asking along with how to fix the problem. The Committee hopes to address this by June 2002.

Mr. Pierce said it might take a number of meetings to answer everyone's questions.

Mr. Saathoff suggested holding a Board workshop to further address this. It would be extremely valuable if both Mr. Roeder and Mr. Blum could be present.

Mr. Vortmann clarified that the workshop would only address the immediate issues.

Mr. Pierce agreed.

For the record, Ms. Lexin stated that there are a number of perspectives that have not been discussed.

Ms. Shipione suggested inviting the City to present their concerns and recommendations.

Ms. Lexin said she, Ms Webster and Ms. Vattimo represent the City on this Board.

Staff was directed to schedule a workshop.

Please note: An email was received from the Board's actuary, Rick Roeder after the meeting concluded asking that it be included as a part of the minutes to clarify his comments (Attachment A), with Staff's presentation materials to follow (Attachment B)

XIII. NEXT MEETING: FRIDAY, MAY 17, 2002 - 1:30 PM

RETIREMENT SYSTEM BOARD ROOM
401 "B" STREET, SUITE 400, SAN DIEGO, CA 92101

XIV. ADJOURNMENT - The meeting was adjourned at 5:00 p.m.

Minutes prepared by Board Secretary, Sally Zumalt

proved by: _____
Lawrence B. Grissom, Retirement Administrator

EXHIBIT 18

Dear Fred,

I urge you to review the policy and fiscal soundness of using CERS Trust Fund (Fund) assets to pay 8% interest earnings to retirees who have left their DROP money on deposit with the CERS. It is my understanding that the Fund, and thus indirectly the City, is under no legal obligation to pay such overstated earnings in today's market to retirees who choose to "invest" their DROP funds with CERS. As of October 30, 2002 the CERS Trust Fund had net investment losses of over \$50 million and the actuary advised the Fund incurred an actuarial loss of \$313 million for the Fiscal Year ending June 30, 2002.

Currently about 250 retirees have left \$38.9 million in DROP funds on deposit with CERS. At an 8% interest rate the fund is paying out over \$3.1 million annually. As a comparison the 2002 13th check full cost was \$3.8 million.

The amount on deposit is increasing this fiscal year by an average of \$2 million a month. The increasing balances below illustrate how fast this expense is growing.

Date as of	DROP Amounts Left On Deposit by Retirees	Interest at 8%	
June 30, 2000	\$ 3.8 million 38,600,000	\$300,000	
June 30, 2001	\$8.1 million > 38% grows at rate of 1.6m/month	\$649,000	
June 30, 2002	\$31.0 million	\$2,480,000	
Nov. 30, 2002	\$38.8 million	\$3,100,000	

I also request review of the practice of crediting DROP accounts of active employees at 8%. While active employees are in DROP, the DROP program should be administered as the defined contribution program that it is, rather than a "guaranteed" defined benefit program that it is not. An option to explore is contracting out the DROP program like the City's other defined contribution plans. This gives the members control over their own investments and stops the questionable practice of paying out 8% when the Fund is in a negative investment environment. By contracting out the DROP program members can have the opportunity to earn above 8% when the general investment environment improves.

One could conclude that in the current negative earnings environment the defined benefit plan is subsidizing DROP, the defined contribution program. I don't believe that was ever the intent of the City. The DROP program was still fairly new, with relatively low dollars on deposit, when the stock market took its downward turn in 2000. To date, the Fund has incurred net negative earnings due to the DROP program.

This might be handled more expeditiously and therefore benefit the Fund if the issue is handled in two phases. First, reviewing the policy of DROP funds on deposit by retired members and second, reviewing the policy of DROP funds on deposit by active members. I urge immediate attention to this matter since the Fund is incurring daily losses due to the current practice of crediting 8% to retired and active DROP accounts.

→ PSC not paying for itself
From ED RYAN and Mike U (?)

→ \$106m on deposit for DROP as of 10-31-02 including
both active + retired. will increase greater with new 906 cap.

→ 8% on members accounts -

→ or other global review recommended to City Strategic Fiscal

EXHIBIT 19

Terri Webster - Possible Adverse Effect of DROP on Payment of 13th Check and Corbett Settlement

From: "Judy Folsom" <jfolsom1@san.rr.com>
To: <Pbnuggets@aol.com>
Date: 1/13/2003 8:31 AM
Subject: Possible Adverse Effect of DROP on Payment of 13th Check and Corbett Settlement
CC: "Nancy Acevedo" <jacevedo1@cox.net>, "Stan Elmore" <Sselmore@aol.com>, "Robert West" <rwest2@san.rr.com>

It appears that increased active member benefits and the permanent continuation of the DROP could effectively eliminate both the 13th check and the Corbett settlement payments. (If there are no funds from Surplus Undistributed Earnings available, the Corbett settlement pay-outs could accrue, but not be paid due to lack of funds.)

As part of the Corbett lawsuit settlement, the City increased the retirement factors for General and Safety Members. An additional increase in factors will occur during FY2004. Also, salaries will increase due to new cost-of-living adjustments. Future DROP participants will have substantially higher retirement allowances. (We have already seen allowances in the \$6,000-\$10,000 range.) Monies do not have to be withdrawn from DROP accounts at the time of termination from City employment and can be left on account almost indefinitely. With bank interest rates in the 2%-3% range, we can expect deferred withdrawals from the accounts.

The Schedule for Distribution of Earnings at June 30, 2000 reflects a distribution of **\$2,333,465** for DROP account interest. The independent auditors' report on the Schedule of Changes in Surplus Undistributed Earnings for the year ended June 30, 2002, reflects that the distribution from Surplus Undistributed Earnings was **\$6,424,652**, an increase of approximately \$4.1 million, or an alarming **175%** over a two year period. (See the table below.)

Any interest credited to the DROP accounts reduces the amount of Surplus Undistributed Earnings available to pay the 13th Check and the Corbett settlement. DROP accounts are credited with the assumed interest rate of the fund (8%) regardless of whether or not there are sufficient undistributed earnings. If Surplus Undistributed Earnings are not available, monies are transferred from the Employer Contribution Reserve. Therefore, the balances in DROP accounts will continue to grow even when there are no Surplus Undistributed Earnings. When there are Surplus Undistributed Earnings, interest will be credited to the DROP accounts before the 13th Check and Corbett settlement are paid. **In future years, the interest credited to DROP accounts might eliminate any funds available to pay the 13th check and the Corbett settlement.**

Do you know if the actuary or Larry has done any projections relating to DROP interest accrual? What are the projected distributions over the next 5-15 years? Due to the current economic climate and increasing interest accrual, the Board may have to authorize larger transfers from the Employer Contribution Reserve to cover DROP interest payments. What effect will this have on the funding ratio of the Trust Fund?

At one point, there was a legal opinion that SDCERS could create reserves, but not expend from them. One recommendation was to eliminate the General Reserve, the Reserve for Retirement Changes, the Contingency Reserve and the NPO Reserve and transfer their balances into the Employer Contribution Reserve. This reserve is credited with interest from Surplus Undistributed Earnings before payment of the 13th Check and the Corbett lawsuit settlement. Collapsing these reserves into the Employer Contribution Reserve would reduce the money available to pay the 13th check and the Corbett lawsuit settlement.

Have any other recommendations regarding the reserves been made? If the Board cannot expend from these reserves, what will happen to them?

Schedule of Changes in Surplus Undistributed Earnings-Allocation of earnings (8%)

DROP Contributions 2000: \$2,333,465

DROP Contributions 2002: \$6,424,652

% of Increase: 175.3%

Members' Contributions 2000: \$21,119,014

Members' Contributions 2002: \$26,826,930

% of Increase: 27.2%

City and Unified Port Contributions 2000: \$33,631,231

City and Unified Port Contributions 2002: \$35,129,813

% of Increase: 4.5%

EXHIBIT 20

Deferred Retirement Option Plan (DROP)

The City created and authorized the San Diego City Employees' Retirement System Board (Board) to administer a DROP program in 1997. DROP is an alternative way for eligible SDCERS members to earn retirement benefits in addition to their biweekly paycheck for up to five years and for Fire Members the five years can be extended with unused leave.

The DROP program operates similar to a defined contribution program, like SPSP; in that member's DROP accounts are their personal investment account. The assets in DROP accounts are not included as assets of the retirement system by the actuary. Funds are held in separate accounts only for distribution to the individual members.

While an employee is in DROP, their account accumulates retirement benefits which can only be withdrawn up actual termination/retirement from the City. DROP accounts receive member's monthly pension check; a 3.05% deposit from the member's biweekly paycheck which is matched by the City; and the 13th check and COLA when applicable. In addition these accounts earn 8% interest.

As of May 31, 2003 there was 690 DROP Active Members with funds totaling over \$83,000,000 which at 8% interest earn over \$6,640,000 in annual interest.

As currently administered, once DROP members terminate/retire they are allowed to leave their money on deposit with SDCERS and earn 8% interest. They also have the option to pull out their money in lump sum or as an annuity.

As of May 31, 2003 there was 275 DROP Retired Members with funds left on deposit totaling over \$48,000,000 which at 8% interest earn over \$3,800,000 in annual interest.

The DROP program, as administered for the retired members, has since inception caused the assets of the system to decrease since it has not earned the interest at least equivalent to what it is paying out to the DROP accounts. For example, in Fiscal Year 2003 the SDCERS Trust Fund has earned negative interest while paying retirees an 8% interest rate on their DROP accounts. These results in a decrease of the assets held for future monthly payment to retirees for their basic defined benefit. This also decreases the funding ratio of the system, increases the UAAL which increases Employer Contributions. {Have Rick/Leslie price out?}

The increasing DROP balances below illustrate the interest expense growing at an alarming rate.

Date	Amounts Left On Deposit by Retirees no longer in DROP	Annualized 8% Interest
June 30, 2000	\$ 3,800,000	\$ 304,000
June 30, 2001	\$ 8,100,000	\$ 648,000
June 30, 2002	\$ 31,000,000	\$2,480,000
May 31, 2003	\$ 48,400,000	\$3,872,000
June 30, 2003	52,271,510	4,182,000

invest
\$ 6.6 ann
38
\$10.4m

The City Auditor and Comptroller in January 2003 made recommendations to the SDCERS Board.

Recommendation 1: Contract out the DROP program with a third party administer in the manner in which the City does with its defined contribution programs like SPSP. Implicit in this recommendation would be that the investment market would drive the rate of return on these monies, not a rate set by the Board. And if this recommendation is not adopted then he recommended:

Recommendation 2: Immediately change the 8% interest paid to DROP accounts for retirees who are no longer in DROP but who have left their funds on deposit with SDCERS. He believes market rates should be paid in good or bad years.

Recommendation 3: Review the practice of crediting DROP accounts 8% for members currently in DROP.

To date the Retirement Board has not changed its practice of crediting 8% interest to the DROP accounts of the active members or the retired members. The City Manager and City Attorney are looking into options available to the City if the Board does not change its practice.

EXHIBIT 21

DROP Cost Neutrality

Much discussion has taken place concerning the DROP (Deferred Retirement Option Plan) for Members of SDCERS. There is significant debate as to whether the DROP is "cost neutral" in practice, as was the intent at its creation under MP1. Based upon my analysis, I will show that the SDCERS DROP is, in design, not cost neutral.

DROP Overview

After an active Member of SDCERS becomes eligible for retirement, he or she may decide to participate in the DROP. If the Member elects to "DROP" (participate in the DROP), the employee ceases to be considered an active Member for purposes of SDCERS. Instead of being an active Member who continues to accrue benefits, the Member is considered retired for pension purposes. The monthly Service Retirement Allowance of the Member is calculated at the DROP date using Final Compensation, Years of Service Credit and the Retirement Factor in effect at that time. While the Member participates in the DROP (a period not to exceed five years), he or she continues to work and receive a salary, but not Years of Service Credit. At the same time, the monthly Service Retirement Allowance the Member would have received is credited to a DROP account. Assets in the DROP account earn interest at the rate of 8%, compounded quarterly. The Member and the City cease to make contributions toward retirement benefits. However, the Member and the City each contribute 3.05% of salary to the DROP account.

In the SDCERS DROP, cessation of employment is required at the end of the DROP period. At that time, the balance in the DROP account is available to the Member, either as a lump sum, an annuity or a combination of both. The balance may also be left to earn further interest or it may be rolled over into an Individual Retirement Account.

DROP Advantages and Disadvantages for the City

The DROP gives the City an opportunity to retain experienced employees who are otherwise eligible to retire. The higher salaries of the retained employees are not pensionable, but the efficiency and productivity of experienced employees is retained. Since the baby boomer generation will soon be retiring in large numbers, it may be difficult for the City to replace employees who are valuable members of the workforce. It is also possible that the City can save on training, retiree medical and other costs.

Although the DROP may be designed to encourage valuable employees to remain with the City, adverse selection may occur if employees not fitting this goal also

remain. Adverse selection is also possible if the Member anticipates lower than expected salary increases.

Based on the analysis below, you will see that there is a cost to the City of supporting the DROP. Participating in the DROP provides a more valuable benefit for the Member. The cost of the increased value of the benefit is borne entirely by the City.

DROP Advantages and Disadvantages for the Employee

A DROP combines the cash accumulation feature of a defined contribution plan with the security of a lifetime benefit of a defined benefit plan. When an employee who has DROPPed retires, he or she has the availability of a lump sum cash settlement together with a lifetime pension, although the pension may be lower than it would otherwise have been without the DROP. The lump sum may be used for expenses incurred early in retirement, or it may be rolled over to an Individual Retirement Account, allowing taxation to be deferred.

With a Retirement Allowance Factor capped at 90%, service after reaching the cap does nothing to increase the employee's pension. A DROP allows the employee to continue working beyond meeting the cap limit, while being credited with a monthly Service Retirement Allowance that would otherwise have been forfeited.

The DROP election is most likely to cause a more valuable benefit to be received. This can happen if the employee receives salary increases during the DROP period that are less than anticipated, since such lower increases would have been considered in the post-DROP monthly Service Retirement Allowance.

Public Perception of a DROP

Eligibility age for unreduced benefits in public retirement plans is generally earlier than in private retirement plans. Many arguments have been made for this, claiming it necessary that the age be earlier. If that is the case, why do we now provide a means to keep employees to a later age? Are the reasons for earlier ages previously put forth no longer true?

Many in the private sector have seen their 401(k) balances hit by the recent bear market. Why are public employees given large lump sums based on guaranteed rates of return with little or no risk?

DROP participation is often seen as "double-dipping." Often the fact that the employee has earned the DROP benefits, and that they would have been paid anyway if the employee retired, is ignored.

DROP Cost Neutrality

True cost neutrality can only be determined based upon the actual experience of the System. However, the SDCERS DROP is designed such that it has the likelihood of increased cost to the City.

Originally DROPs were created for safety employees only. Some general employees can be extremely high paid and could get very large lump sums. Today that is also true of safety employees.

The rate of interest credited to the DROP account must be conservative. Many jurisdictions design their DROP to credit interest at 50% to 75% of the valuation interest rate. SDCERS credits the full valuation rate.

SDCERS allows eligibility for entry into the DROP at the earliest age the Member is eligible for unreduced pension benefits. This encourages Members to DROP at ages earlier than the average assumed retirement age used by the actuary. That in turn raises plan costs.

A Member who enters the SDCERS DROP is credited with 100% of his or her accrued monthly benefit at the time of entrance. Most cost neutral DROPs limit the credit to less than 100% of the accrued monthly benefit.

I have considered various components of cost or savings created by the SDCERS DROP. In doing so, I have looked at various combinations of assumptions as to age at DROP participation, length of DROP participation, investment return credited, salary increases during DROP participation, Final Compensation at the time of entering the DROP, years of Service Credit at the time of entering the DROP, probability of a DROP participant receiving credit for a 13th check while participating in the DROP and rate of employee contribution.

I have reviewed the Actuarial Valuation as of June 30, 2006, prepared by the SDCERS actuary and the City of San Diego Manager's Report No. 05-012, dated January 10, 2005, entitled "Analysis of the Deferred Retirement Option Plan (DROP)." I have also reviewed a Letter from Rick A. Roeder, of Gabriel, Roeder, Smith & Company dated June 22, 1999, which is a "second draft of DROP's financial impact." From these, I have gathered the statistics on the following page.

	<u>General Members</u>	<u>Safety Members</u>	<u>All Members</u>
Number of DROP Participants at June 30, 2006	530	429	959
Historic Average Age Upon Entering Drop	57.70	52.50	55.38
Historic Average Years Service Credit Upon Entering DROP	28.55	27.31	27.99
Historic Average Years in DROP	2.72	4.54	3.55
Average Annual Benefit in DROP at June 30, 2006	\$42,007	\$67,500	\$53,411
Historic Average Years Service Credit Upon Retiring Without Entering DROP	22.57	19.62	21.79
Average Salary of a Member Meeting These Average Statistics	\$62,436	\$87,463	\$67,561
Average Salary of a Recent New Hire	\$40,670	\$44,602	\$42,174

Value of the Service Retirement Allowance

The value of the Service Retirement Allowance has been calculated as the single sum present value of future benefits expected to be received by the DROP participant. I have calculated the value of the Service Retirement Allowance at the time of entering the DROP and again at the same time as if there were no DROP option available.

Based on the statistics I have gathered, along with our calculations, I have found that the values of the Service Retirement Allowance for "average" Members can be represented as follows:

- General Member – Age 58 upon entering DROP – 29 years of Service Credit upon entering DROP – 3 years in DROP – \$62,500 salary upon entering DROP
 - Value of Service Retirement Allowance upon entering DROP at age 58 is \$630,000

- Value of Service Retirement Allowance at age 58, but retiring at age 61 with no DROP option is \$580,000, assuming 3.5% salary increases for 3 years – increased cost to the City is \$50,000
- Value of Service Retirement Allowance at age 58, but retiring at age 61 with no DROP option is \$600,000, assuming 4.75% salary increases for 3 years – increased cost to the City is \$30,000
- Value of Service Retirement Allowance at age 58, but retiring at age 61 with no DROP option is \$620,000, assuming 6% salary increases for 3 years – increased cost to the City is \$10,000
- Safety Member – Age 53 upon entering DROP – 27 years of Service Credit upon entering DROP – 5 years in DROP – \$87,500 salary upon entering DROP
 - Value of Service Retirement Allowance upon entering DROP at age 53 is \$1,090,000
 - Value of Service Retirement Allowance at age 53, but retiring at age 58 with no DROP option is \$870,000, assuming 3.5% salary increases for 5 years – increased cost to the City is \$220,000
 - Value of Service Retirement Allowance at age 53, but retiring at age 58 with no DROP option is \$920,000, assuming 4.75% salary increases for 5 years – increased cost to the City is \$170,000
 - Value of Service Retirement Allowance at age 53, but retiring at age 58 with no DROP option is \$980,000, assuming 6% salary increases for 5 years – increased cost to the City is \$110,000

If there were no DROP available, it is likely that most Members would retire earlier than they would when participating in the DROP. If I assume retirement would occur two years after the average age at which Members are currently entering the DROP, the costs to the City for a General Member would be \$20,000 assuming 3.5% salary increases for 2 years, \$6,000 assuming 4.75% salary increases for 2 years, or a savings of \$9,000 assuming 6% salary increases for 2 years. There are neither costs nor savings for a General Member assuming 5.25% salary increases for 2 years. The costs to the City for a Safety Member would be \$70,000 assuming 3.5% salary increases for 2 years, \$42,000 assuming 4.75% salary increases for 2 years, or \$20,000 assuming 6% salary increases for 2 years.

From these calculations, I derive the estimated cost to the City when valuing the Service Retirement Allowance is \$3,180,000 for General Members currently in the

DROP and \$18,018,000 for Safety Members currently in the DROP. I have multiplied the costs for an average Member, assuming 4.75% salary increases for 2 years, by the number of current Members in the DROP.

Value of the 13th Check

The value of the 13th check which DROP participants are eligible to receive has been calculated as the single sum present value of future 13th checks expected to be received while in the DROP. For purposes of this calculation, I have assumed a 90% probability that a 13th check would be paid.

For an average General DROP Member, the 13th check has a value of \$2,100 with 3 years DROP participation, or \$1,450 with 2 years DROP participation. Using this latter value, the total 13th check cost to the City associated with the 13th check for General DROP Members is \$768,500.

For an average Safety DROP Member, the 13th check has a value of \$3,025 with 5 years DROP participation, or \$1,350 with 2 years DROP participation. Using this latter value, the total 13th check cost to the City associated with the 13th check for Safety DROP Members is \$579,150.

Value of the 3.05% City Contribution for Safety Members

The value of the 3.05% City contribution which Safety DROP participants are eligible to receive has been calculated as the single sum present value of future 3.05% City contributions expected to be received while in the DROP. General DROP Members are not considered here, since they are already receiving the 3.05% City contributions in the SPSP.

- Safety Member – Age 53 upon entering DROP – 27 years of Service Credit upon entering DROP – 5 years in DROP – \$87,500 salary upon entering DROP
 - Value of 3.05% City contribution upon entering DROP at age 53 is \$13,600, assuming 3.5% salary increases for 5 years
 - Value of 3.05% City contribution upon entering DROP at age 53 is \$14,650, assuming 4.75% salary increases for 5 years
 - Value of 3.05% City contribution upon entering DROP at age 53 is \$15,700, assuming 6% salary increases for 5 years

For an average Safety DROP Member, the 3.05% City contribution has a value of \$6,850 with 2 years DROP participation, assuming 4.75% salary increases for 2

years. Using this value, the total 3.05% City contribution cost to the City associated with the 3.05% City contribution for Safety DROP Members is \$2,938,650.

Value of the Employee Contributions Not Made

The value of the employee contributions which DROP participants no longer make has been calculated as the single sum present value of future employee contributions expected to be received while in the DROP. Since these contributions will not be made by the employees, the City will have to assume the liability.

- General Member – Age 58 upon entering DROP – 29 years of Service Credit upon entering DROP – 3 years in DROP – \$62,500 salary upon entering DROP
 - Value of employee contributions upon entering DROP at age 58 is \$20,600, assuming 3.5% salary increases for 3 years
 - Value of employee contributions upon entering DROP at age 58 is \$22,100, assuming 4.75% salary increases for 3 years
 - Value of employee contributions upon entering DROP at age 58 is \$23,750, assuming 6% salary increases for 3 years

For an average General DROP Member, the employee contributions have a value of \$16,000 with 2 years DROP participation, assuming 4.75% salary increases for 2 years. Using this value, the total employee contributions cost to the City associated with the employee contributions for General DROP Members is \$8,480,000.

- Safety Member – Age 53 upon entering DROP – 27 years of Service Credit upon entering DROP – 5 years in DROP – \$87,500 salary upon entering DROP
 - Value of employee contributions upon entering DROP at age 53 is \$44,650, assuming 3.5% salary increases for 5 years
 - Value of employee contributions upon entering DROP at age 53 is \$47,950, assuming 4.75% salary increases for 5 years
 - Value of Employee contribution upon entering DROP at age 53 is \$51,500, assuming 6% salary increases for 5 years

For an average Safety DROP Member, the employee contributions have a value of \$22,450 with 2 years DROP participation, assuming 4.75% salary increases for 2

years. Using this value, the total employee contributions cost to the City associated with the employee contributions for Safety DROP Members is \$9,631,050.

The totals of the preceding costs are:

<u>Cost Item</u>	<u>General Members</u>	<u>Safety Members</u>	<u>Total Members</u>
Service Retirement Allowance	\$3,180,000	\$18,018,000	\$21,198,000
13 th Check	768,500	579,150	1,347,650
3.05% City Contribution	N/A	2,938,650	2,938,650
Employee Contributions	<u>8,480,000</u>	<u>9,631,050</u>	<u>18,111,050</u>
Total	\$12,428,500	\$30,308,850	\$43,595,350

These costs apply only to those SDCERS Members currently participating in the DROP. They represent approximately 60% of all those who have participated in the DROP since its inception. Therefore, I estimate the cost attributable to these features of the DROP, for all current and past DROP participants to be approximately \$72,500,000.

I have also estimated the present value, as of June 30, 2005, of these costs attributable to future DROP participants who are currently active Members. I estimate the present value of the cost attributable to these features of the DROP, for all future DROP participants who are currently active Members to be approximately \$120,000,000.

The estimated total present value of these costs, attributable to all past and current SDCERS Members is \$192,500,000.

Contrary to the concept that the City experiences savings due to reduced City contributions, no such savings occur. When the Member enters the DROP, his or her liability increases. That liability has not been funded. Those costs will be paid in future increased amortization contributions rates applied to the remaining active Members. There are no savings. The increased contribution rates are considered in the previous points.

Since SDCERS has a record of outperforming the interest rate credited to DROP account balances, the present value of savings on behalf of current active Members is \$600,000.

It is assumed the City will retain experienced and more highly paid workers. Therefore, the City's payroll expenses are increased. Comparing the average salary of a Member currently participating in the DROP to that of an average salary of a recent new hire, I can make an estimate as to the increased payroll costs incurred

by the City. I estimate the present value of the increased future payroll costs to the City to be \$210,000,000. I have not calculated the increased historical payroll costs.

Now the total increased costs to the City are approximately \$400 million.

There are benefits that cannot be measured, such as the retention of experienced employees, a predictable rate of interest and reduced hiring and training costs. These benefits would be lost if the DROP were eliminated.

ACTUARIAL SERVICE COMPANY, P.C.

